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RFD 206

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 16, 1952

NOT FOR PUBLICATION

December 16, 1952

How Large is the World's Dollar Deficit?

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In the articles on "Living with the Dollar" the Economist in its issue of November 22 has drawn a black picture of the future for sterling and other non-dollar currencies. As one means of coping with the problem, and of facilitating nondiscrimination in trade and exchange controls, the authors of these articles have proposed the creation of an Atlantic Payments Union in which debtor countries would surrender some power over their internal economies in return for a United States commitment to give them credit running into the tens of billions of dollars. Why is the Economist pursuing this old mirage of a world clearing union, which in a slightly different shape once fascinated Lord Keynes? Its writers see clearly enough the pointers along the hard road toward international monetary equilibrium: the need for "establishing a bolder and less restricted system of world trade", the need for "curbing [the Commonwealth's] two major extravagances, the uneconomic industrialization programmes in the dominions and the uneconomic sheltering of consumer goods industries in the United Kingdom", the need for "development of raw material production" in the world at large and in the sterling area especially, and the desirability of basing U. S. military offshore purchase decisions so far as possible "on grounds of relative cost and not on grounds of political expediency". Are these aims too difficult of achievement?

The Economist apparently does not despair of progress along these lines. It fears, however that a program of this kind, even with full cooperation given by the United States, would not be enough to restore the pound to good health except with oppressive discriminatory controls. The Economist seems to be persuaded that invincible forces are perpetuating a very large "gap" between the world's demand for dollar goods and the available supply of dollars. Despite all the evidence of slackening demands for dollar goods -- Europe's post-war recovery and advance in production and in exports and in productive capacity; the persistent useful effects of the 1949 devaluations; the happy issue of new credit policies from the regrettable boom and recession of 1950-52; the new recovery in Europe this autumn signalled by rising international trade -- the Economist has apparently allowed its judgment to be influenced by official American balance of payments statistics which can be misinterpreted, and which it has misinterpreted, as supporting the myth of a persistent "dollar gap".

The figures on which the Economist leans so heavily refer to the annual "balance on goods and services" as shown in U. S. balance of payments compilations. These figures, as we shall show, do not provide a measure of the world's dollar deficit in a useful economic sense. Worse, their overstatement of the deficit is greatest for 1951, the last year of the series.

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Table I gives the latest revised figures for 1946 through 1951.

Table I
U. S. Balance on Goods and Services
(In million dollars)

1946	7,704
1947	11,478
1948	6,699
1949	6,371
1950	2,297
1951	5,164

Source: -- Department of Commerce, "Balance of Payments of the United States 1949-1951", Supplement to the Survey of Current Business, 1952. (Hereafter referred to as "Balance of Payments Supplement".)

The Economist presents a large graph under the title "United States Surplus on Current Account" in which these data (or closely similar data from earlier Commerce Department publications) appear. The text then speaks repeatedly of "the now customary dollar gap of between $5 and $8 billion a year", and it characterizes the drop in 1950 to about $2 billion as "probably even more exceptional" than the 1947 rise to a peak of $11-1/2 billion. Some analysis is given of changes in U. S. export and import quantities and values, but the emphasis is altogether on changes between 1937 and the post-war period, with the post-war period regarded always as a single whole. No attempt is made to look for reasons for the decline in the balance between 1946-49 and 1950 apart from the effects of the speculative boom in the latter part of that year.

From this picture of the recent past, the Economist goes forward, through a pessimistic discussion of the future of U. S. imports, to a conclusion that "it will be a very difficult task to keep the world dollar gap below $5 billion a year". An uptrend of U. S. exports matching the expected rise in imports is taken for granted: the question of European competition with U. S. exporters in third markets is barely touched on, and the Economist suggests that the "world dollar gap" may indeed reach $10 billion a year instead of $5 billion "if exchange and import controls are to be significantly eased". One finds in the articles on "Living with the Dollar" little to nourish any hope that "a programme for deliberate disinflation in the Commonwealth" (the words are from the leading editorial article of the same issue of the Economist) might help to hold down purchases of U. S. goods without direct controls.

Judgments about the future gain persuasiveness in proportion to the support they find in the facts of the past or present. Can one accept the statistical series on which the Economist leans as a significant indicator of trends in 1952? Does it, consequently, give us any guide to possibilities in 1953 or in 1958?

Criticism of the figures used by the Economist

The Economist's measure of the world's dollar deficit is defective in a major respect, in that the 1951 figure includes a substantial amount for military equipment given to other countries by the United States. The series of figures used by the Economist provides a poor guide to current trends not only because of this overstatement of the 1951 deficit, but also because the series ends with 1951, when the deficit was larger than in either the year before or the year after. These two points are sufficient to destroy the Economist's thesis that the deficit, thus far, has been persistent and not declining. A third criticism must be that these figures overstate the "United States surplus on current account" in every year, including 1951, because they do not account for private remittances from the United States along with payments for U. S. imports of goods and services.

When the necessary adjustments are made and the series is extended forward by estimates for 1952 and for the 1952-53 fiscal year, the picture that emerges is quite different from the one the Economist has given us. It is a picture of real progress toward elimination of the world's dollar deficit. We shall take up the various points one by one.

Treatment of military aid

As soon as military aid is deducted from the "balance on goods and services" the Economist's series is transformed into one that shows a downward trend after 1947, even without the help of the 1952 figure that is now in the making.

Table II
U. S. Balance on Goods and Services after Deducting Military Aid
(In million dollars)

	Adjusted balance	Amount of Military Aid
1946	7,704	0
1947	11,404	74
1948	6,279	420
1949	6,169	202
1950	1,723	574
1951	3,702	1,462

Source: -- As for Table I.

A certain perfectionism in national economic accounting in the United States has caused this country to include in its monthly statistics of exports most of the munitions ("military equipment and supplies") that are shipped out of the United States by the Defense Department to be transferred to foreign ownership 1/, and to include in its balance-of-payments export compilations not only all such shipments but also munitions transferred to foreign ownership after procurement abroad. 2/ Few other countries (if any) include military equipment granted, or received by grant, in their export-import statistics, nor do they intermingle military-aided exports of goods and military-aided exports of services (e.g. freight) with civilian-financed goods and civilian-financed services respectively, in their balance of payments statistics. Canada shows in its balance of payments on current account a lump credit for "Mutual Aid" but this is offset by a contra-debit of the same title before the balance is taken on current account. The United States, in its accounting perfectionism, takes a balance first "on goods and services" and leaves the military aid debit to be called a "unilateral transfer".

This explains why the Economist, quite naturally, has used and been misled by figures that include exports of military end-products and their transportation costs and other military services financed by U. S. grants. Are not these figures the wrong ones to use for the purpose of measuring changes in the world's deficit with the United States? Is there any justification for their use?

One can say of most types of economic aid, certainly of ERP aid and its recent successor the defense-support aid to Europe administered by MSA, that exports financed by this aid meet a market demand in foreign countries. In the absence of this aid, one (or more) of three things might happen: the country might allow import purchases to continue at the expense of its monetary reserves, or it might stiffen its import controls to prevent the market demand from being effective, or it might take actions in the fiscal and monetary and exchange rate fields designed either to reduce the strength of the market demand or to increase foreign exchange earnings, so as to replace the aid in financing the imports demanded. If one could say all this again of military aid, the Economist's choice of data might be justified.

Obviously the demand for military exports from the United States is not directly susceptible to influence by fiscal or monetary action. Surely we must also say that the possibilities of using import controls or financial policy to curtail non-military imports, in order to make room for military imports on anything like the present scale, are narrowly limited for most countries. These considerations gain force when we remember that the United States and the other NATO countries are engaged in a joint effort in which

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1/ See, for example, Table 2 in the Census Bureau's Summary Report FT900, "United States Foreign Trade, September 1952", dated November 14, 1952.
2/ See "Balance of Payments Supplement", p. 21.

some are to contribute by military production for export and some by using, in the common cause, the equipment provided by others. A useful analysis of the free world's balance of payments problems should not count military shipments as adding either to the exporters' surpluses or to the importers' deficits. This particular component of the "dollar deficit" is not one that needs to be eliminated or covered by greater dollar earnings.

The general answer is clear enough. There are, however, two border line questions which ought to be examined.

First, does the argument against counting military shipments as a component of the U. S. surplus, or the world's dollar deficit, apply also to non-military shipments financed by "defense-support" aid, i.e. by economic aid 1/ granted not in consideration of balance-of-payments difficulties so much as in consideration of the general burden of defense efforts upon the recipient's economy? The United Kingdom Treasury, in its latest balance of payments publication, treats (economic) defense aid as a current account receipt reducing the deficit.2/ (This is equivalent, so far as the current account balance is concerned, to leaving out the imports financed by defense-support aid.) In figuring the United States balance of payments surplus, should we make the same kind of downward adjustment as the British Treasury has made? Probably the answer ought to be "no". It is true that the major criterion for grants of aid is no longer found in the immediate and short-run balance-of-payments situation of a country. Nevertheless, the ultimate purpose in all grants of economic aid has been the same: to promote stability and growth in the recipient economy by providing resources that will enable it, sooner or later, to import more than would otherwise be possible.

Second, what is the right treatment for military offshore purchases in cases where military equipment is procured not for U. S. use but for transfer to a foreign country, either the supplying country or some other? This question has some significance because the allocation of offshore purchases to one country or another and the determination of the total amount to be spent in this way do depend in part on considerations of balance-of-payments difficulties and general economic burdens. Offshore purchases thus border closely on cash aid, particularly in those cases where it is arguable that no additional burden on resources is involved because the goods might have been produced even without a dollar purchase contract. The present treatment in the U. S. balance of payments, as in the accounts of countries that produce on contracts for which

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1/ U. S. balance of payments statistics classify defense-support aid as "economic".

2/ Cmd. 8666, October 1952. See, for example, p. 35. See p. 29 regarding military aid.

dollars are received, is to make these purchases appear as normal current account transactions.1/ Thus our surplus is reduced by the amount of these purchases. Should we link these purchases with the related transfers of ownership and leave both out of the goods and services account, treating the disbursement of dollars simply as cash aid?2/ To put it another way, still linking the offshore purchases and related transfers, could we keep the purchases in the current account but at the same time put there too, as an offset, that part of military "exports" that in fact is procured abroad? This would tend to make our surplus or the world's dollar deficit appear somewhat larger — in the future at least, for the amounts have been negligible up to now. The answer again should probably be "no". The criterion that should guide us in this case looks to the future rather than the past or present; we may hope that offshore purchases (for subsequent transfer under military aid) will always represent additional production that could not otherwise have been attempted, and that increasingly it will be possible for offshore purchases to be determined primarily on economic considerations of efficiency and cheapness of supply, so that in every sense these purchases will be current purchases of goods from other countries by the United States. The United States will need

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1/ When an offshore purchase is transferred to foreign ownership through military aid, four equal entries occur in the U. S. balance of payments accounts: a debit for the purchase (under goods and services), a credit for dollars (outside the current account) a credit for the transfer to user (goods and services), and a debit for the military aid (unilateral transfer).

2/ I.e., eliminate the first and third of the entries listed in the preceding footnote.

the goods (to meet its military aid commitments); and the sources of supply would not be determined by considerations of aid.1/

Before we leave the subject of military aid we may mention that other military expenditures abroad (besides the offshore purchases connected with military aid) have already been helping to reduce the world's dollar deficit. Indeed, in 1951, U. S. military expenditures of all kinds may have exceeded one and a quarter billion dollars, and the amount will be larger still in the future.2/ We would no more consider adjusting the deficit upwards

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1/ Even if it were desirable, it would not be possible to take out of the current account military offshore purchases destined for transfer under military aid, because U. S. balance of payments data will not disclose the amounts of these purchases for transfer. The Balance of Payments Supplement, Appendix Table 6 (p. 140), shows for 1951 a net adjustment of Government imports of $506 million. This includes not only offshore purchases for foreign-aid programs (economic as well as military) but also procurement for other Government uses abroad. The corresponding figure for 1950 (excluding in both years the adjustments for grain storage in Canada) is $272 million; this includes $222 million of purchases by military agencies for all purposes. Total offshore purchases for all aid programs in 1950 were $46 million, according to Table 1 (p. 24).

Appendix Table 4 (p. 136), dealing with export adjustments, shows that Government military-aid transfers exceeded recorded Government military-aid program exports in 1951 by about $320 million. This may include not only transfers of offshore purchases but also unrecorded actual shipments from the United States and transfers from U. S. stocks abroad. The corresponding figure for 1950 is $222 million. Total Government transfers exceeded recorded Government exports in 1950 by $341 million. Total aid-program transfers of goods procured abroad were $51 million in 1950, as shown on page 21.

The relatively small 1950 offshore purchases for aid programs (and aid-program transfers) were presumably for non-military programs. If, as appears possible from the figures given here, there was an increase in aid-program purchases and transfers in 1951, this would still be likely to be in programs other than for military assistance. It has been announced that $621 million of contracts were let in the fiscal year 1951-52 for procurement with military assistance funds, but it is likely that very little of this amount was expended by June 30, 1952.

2/ See the preceding footnote with regard to military purchases of goods. Total Government payments for miscellaneous services in 1951 were $1,084 million; no breakdown is given. The corresponding 1950 figure was $601 million, of which $380 million were the expenditures of military agencies (Balance of Payments Supplement, Appendix Table 19, p. 148). For goods and services combined, expenditures by military agencies totaled $602 million in 1950. The increase between 1950 and 1951 can only be surmised from the increase in aggregate Government expenditures, which was $717 million (506-272 = +234 for offshore goods and 1,084-601 = +483 for services).

by taking out these expenditures, on the ground that they cannot be counted on to continue forever, than we would adjust U. S. imports to take out purchases for Government stockpiles. For the foreseeable future, large U. S. military expenditures abroad will remain a part of the environment in which the countries of the free world will be seeking solutions of their problems.

These remarks on the treatment of military aid may be summarized as follows.

(1) The United States is committed to financing military exports under a policy of promoting the mutual security of the free world, and these exports should not be counted as a component in the world's dollar deficit. (2) It might be argued that the part of our military aid which is channeled through offshore purchases will, in fact, provide cash aid for general balance-of-payments purposes, and that "exports" of military equipment procured abroad should accordingly be counted as a component in the world's dollar deficit (in order to offset, within the current account, the offshore purchase receipts by foreign countries) so that the receipt of dollars would be attributed to aid (rather than to trade). Our conclusion, however, has been that the placing of offshore purchases is expected to be (or should be) on the basis of real economy of cost and that these contracts ought to evoke production that would not otherwise occur; to the extent that this is so, we are right in treating such purchases as commercial transactions. (3) Neither offshore purchases nor other military expenditures abroad should be taken out of the current account on the ground of their being in some sense extraordinary, since in fact they will be continuing. (4) Defense-support aid, on the other hand, like general balance-of-payments aid, should be treated as an impermanent means of financing dollar deficits, not as a current receipt reducing the deficits.

Definition of the "Current Account"

Every attempt to split up the balance of payments of any country into two equal and opposite parts, one to represent the "surplus" or "deficit" and the other the means of financing, requires an arbitrary decision. We might, for example, consider it reasonable to use the sum of grants given plus gold and dollars received as a measure of the means of financing. The "surplus" financed by this sum would automatically be defined as the net surplus not only of current transactions, but also of capital transactions other than gold and dollar movements, and errors and omissions. Measuring the "surplus" by way of the means of financing is a useful device, but the point to notice here is that it involves an arbitrary decision to count certain capital movements as a component (presumably a negative component in the United States case) of the "surplus" and not as part of the means of financing. In its measurement of what it calls the "dollar gap" the Economist, perhaps unconsciously, has made an arbitrary decision of the same sort, by not subtracting from the U. S. surplus on goods and services the amount of net remittances from the United States to other countries. The Economist has implicitly left remittances to be counted as part of the means of financing.

The usual practice outside the United States, approved by the International Monetary Fund, is to treat remittances as part of the current account. Table III, in which the data are adjusted to conform with this practice, shows that the world's dollar deficit on current account (after deduction of military aid but before deducting grants for economic aid) was actually reduced to little over $1 billion in 1950 and was not much over $3 billion in 1951. The chart gives the same figures on a quarterly basis.

Table III
U. S. Balance on Current Account
(In millions of dollars)

	Adjusted balance	Unilateral transfers deducted from balance shown in Table II	
		Private	"Other" Government
1946	7,011	679	14
1947	10,693	665	46
1948	5,543	678	58
1949	5,538	522	109
1950	1,165	481	77
1951	3,220	412	70

Source: — As for Tables I and II. The first column gives the balance on goods and services and unilateral transfers other than economic aid. The unilateral transfers in the third column are Government unilateral transfers other than military aid and economic aid.

Decline in the world's dollar deficit in 1952

United States imports have remained at a high level this year but foreign purchases of U. S. goods have fallen off. U. S. outpayments on services, including U. S. military expenditures abroad, are substantially larger than two years ago. When figures for the year 1952 become available they will certainly show a smaller world dollar deficit than that of 1951. The deficit for the second half of 1952 will be much smaller than the deficit in the first half.

To some extent the improvement between 1951 and 1952 will have to be ascribed to new restrictions placed on purchases of dollar goods, rather than to a decline in what the Economist calls "the ITO gap", i.e., the excess of demand for U. S. goods (as opposed to actual purchases) over the available supply of dollars. But "the ITO gap" did not rise between 1950 and 1951 in proportion to the visible deficit; direct restrictions were relaxed in 1951. When the second half of 1952 is compared with 1950, it will be difficult to demonstrate that foreign direct controls over dollar imports are more severe now than then. Certainly an important cause of improvement in the world's dollar deficit has been the initiation of new domestic monetary policies in many countries in 1951 and 1952 and its twin consequences: diminution of demand for imports and improvement in export supplies.

Table IV gives some indication of the present size of the deficit on the basis we have used in Table III and also, for the sake of comparison, on the basis used by the Economist. The data for the first and second quarters of 1952 are those published by the Department of Commerce in September; the second quarter results are due to be revised this month, when preliminary figures for the third quarter will be published. The figures for the whole year 1952 and for the current fiscal year are extremely rough estimates. They reflect the indications given by trade statistics through September (and through October by the official preliminary estimate of exports) and they take account of normal seasonal variations to be expected in trade and service transactions, with some allowance for upward trends in various types of receipts and

Table IV
U. S. Balance on Current Account 1950-1952
(In millions of dollars)

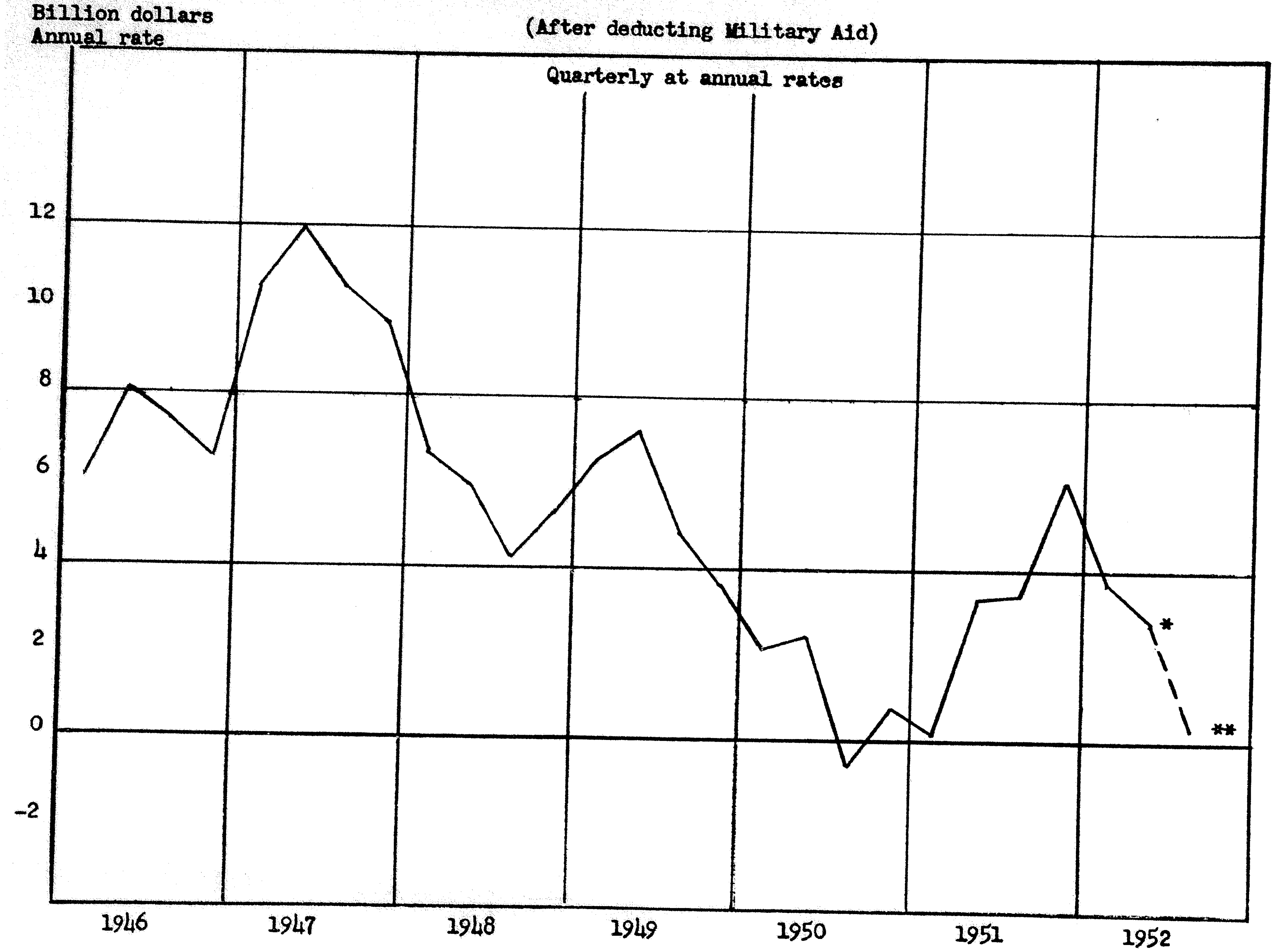
	Adjusted balance a/	Recorded trade balance b/	All other items combined	Balance on goods and services before deducting military aid c/
1950	1,165	1,141	24	2,297
1951	3,220	2,998	222	5,164
1952:				
1st quarter annual rate	3,700	3,970	-270	5,820
2nd quarter annual rate(p)	2,780	3,370	-590	5,630
3rd quarter annual rate	...	970	...	...
Estimate for year	2,200?	2,600?	-400?	about 5,000?
Fiscal year 1952-53, est.	1,500?	2,200?	-700?	?

(p) - Preliminary.

a/ The first column in Table III, carried forward. Differs from the Economist's figures by deduction of military aid, private remittances and "other" Government unilaterals.
b/ Excluding Department of Defense shipments of grant-aid military equipment and supplies.
c/ The Economist's figures as in Table I, carried forward.

UNITED STATES SURPLUS ON CURRENT ACCOUNT

(After deducting Military Aid)



* Preliminary
** Est. by Fed. Res.

payments. Of these trends the most important quantitatively is the rise in Government expenditures abroad, which is assumed to be continuing.1/

In the third quarter of 1952 the world's dollar deficit (as measured by the U. S. balance on current account) appears to have fallen far below $1 billion, annual rate. Exports were exceptionally low, as the effects of the recession in demand in some countries coincided with the cuts in dollar purchases forced by import controls and with the normal seasonal lull in U. S. agricultural exports. This was also the season of maximum U. S. tourist expenditures. It is hardly likely that the deficit will remain at so low a level as this. For the present, we must probably count on a deficit of somewhere between $1 billion and $2 billion, on the basis of measurement used here. This estimate makes very little allowance, however, for military offshore purchases under the assistance program, and a year or two from now these may make an appreciable difference. Thus, it is entirely possible that in the foreseeable future the deficit will have fallen, not just for a season but through a full year, below what once seemed the extraordinarily low level of $1 billion. Meanwhile the outflow of U. S. capital should rise. When these things happen, we should be seeing a gradual dismantling of discriminatory trade controls over dollar purchases.

Other measures of the world's dollar deficit

With a larger outflow of U. S. capital, measurements of the world's dollar deficit that are based only on current account transactions might become misleading. A "deficit" that could be covered by a steady outflow of capital would not constitute much of a problem.

The question ought therefore to be asked whether the world's current account deficit in the past few years -- even when calculated on the right basis -- may already be overstating the seriousness of the dollar problem. As it happens, the figures we have been using do give a slight overstatement of this kind. This can be seen from the indicator of the United States balance of payments surplus which appears in the first column of Table V. This has been derived by summing up certain selected means of financing, namely: economic grant aid, the net movement of U. S. Government long-term capital plus private U. S. purchases of IBRD securities (for 1946-1948), disbursements on

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1/ According to U. S. quarterly balance of payments data, Government payments for miscellaneous services increased by more than $600 million from the fiscal year 1950-51 to the fiscal year 1951-52. A somewhat smaller increase for the fiscal year 1952-53 has been included in the estimates of Table IV. A relatively moderate allowance has been made for increasing offshore purchases of goods. These are not intended as predictions, but as assumptions on which a rough estimate of the surplus may reasonably be based.

ECA-MSA loans (for 1949-1952), U. S. purchases of gold,1/ and net decreases in foreign dollar holdings;2/ with the gold and dollar items treated as deductions when gold was sold or foreign dollar holdings rose, as in 1950.

Table V
Alternative Measures of the U. S. Surplus
(In millions of dollars)

	Selected means of financing a/	Balance on current account b/
1946	6,812	7,011
1947	10,332	10,693
1948	5,496	5,543
1949	5,888	5,538
1950	485	1,165
1951	3,183	3,220

a/ See text for description.
b/ As in Tables III and IV.

It will be seen that the results given by this indicator do not depart significantly from the showing given by the balance on current account, except in 1950. In that year, the U. S. surplus (or world dollar deficit) as defined by this indicator was much the smaller of the two. This was because of the exceptionally large outflow of U. S. private capital to Canada that year, and also because of a temporary slackening of the net inward movement (presumably of foreign capital at least in part) that shows up as errors and omissions in the U. S. balance of payments.

In most years errors and omissions were large. Together with a net inflow (beginning in 1949) of identified foreign capital other than "dollar holdings", errors and omissions tended to offset the outflow of U. S. capital. Thus, the "surplus" defined to include all these movements — specifically,

1/ From foreign countries and international institutions (net), excluding domestic production.

2/ Liabilities to foreign residents and international institutions as reported by banks in the United States, including short-term and certain other Government securities held, with certain adjustments for comparability.

the surplus financed by economic grants and loans and by gold and dollar transfers to the United States -- tended to be of about the same size as the current account surplus rightly measured.

Conclusion

The world's dollar deficit in 1951 -- which should be measured either by the balance of current transactions (after deduction of military aid but not of grants for economic aid), or by the sum of drains on foreign dollar holdings plus foreign gold sales plus economic aid (both grants and loans) -- was of the order of magnitude of $3 billion, not $5 billion as the Economist, using a different basis of measurement, would have us believe. Within the next few years, assuming that reasonably appropriate policies are followed here and in other countries, it is altogether possible that the dollar deficit, on any sensible definition, may decline beyond the low point of about $1 billion reached in the "exceptional" circumstances of 1950.

December 16, 1952

ATLANTIC PAYMENTS UNION

.enry K. Heuser

In its November 22 issue, the Economist tackles with vigor and imagination the problem of the dollar gap and what to do about it. The culminating article of a series of six published in this issue contains a proposal for an Atlantic Payments Union. In general, the suggestion is that under a clearing scheme that includes the United States countries would be able to dispense with discrimination against the dollar area. They would be placed in a position to do this since the United States, like the other participants in the scheme, would agree to accept deposits in the clearing union in all but complete settlement of any foreign surplus that may arise. In its basic philosophy, therefore, the Economist's proposal has more in common with Lord Keynes' Clearing Union than with the European Payments Union in which gold settlements play a major role. I propose to investigate whether the establishment of such a union is more likely than other means to accelerate the restoration of international balance without discrimination.

The proposal of an APU is made against the background of an analysis which is based on the prophecy of a persistent dollar deficit for the Western world. This prophecy, runs like a sustained undertone through six movements of a cantata, through the six articles on "Living with the Dollar". Sometimes it is barely audible, as in "The Commonwealth's Task." At other times, as in "Chasm or Gap," it drowns out with majestic authority the delicate counterpoint of fluctuating rates and disinflation. But hardly has the reader become aware in "Is Discrimination Inevitable" that the gloomy note has all along been scored in the dominant -- crying out for a classical solution -- when he finds himself in the captivating presence of the romantic school. The analogy is not meant to imply that the Economist is carried away by its own idealistic view of political possibilities. The issues confronting the United States as well as the rest of the world could hardly have been posed more boldly. But it is difficult to share the view, implied in the Economist' solution, that the self-interest of nations has grown sufficiently enlightened to assure their ungrudging compliance with decisions made for the common good but affecting their internal policies.

Let it be stated at the outset that the proposal must fire the imagination of all those who consider an approach to common direction of international finance a necessary condition for economic and political progress of the Western world. And ultimately, the case for an Atlantic Payments Union would, indeed, seem to stand or fall with the degree of influence such a mechanism would have on the internal and external policies of member countries. But the stronger the sympathy with the objective the stricter should be the scrutiny of the means. Most of the problems to which compromise solutions were thought to have been found at Bretton Woods are still with us with ever-pressing urgency. The question is, how much have we learned in the meantime, how reliable a guide are the experiences of the intervening period to the solution of these problems? One significant change affecting the direction of financial policy has been the shift from what in 1943-44 seemed a justified fear of underutilization of resources to the need in most countries to contain inflation. It is in the light of post-Bretton Woods' thinking and experience that the proposal for an Atlantic Payments Union might usefully be appraised.

Summary of APU mechanism

The primary objective of the union is to enlarge the area of trade liberalization to include the dollar area. Under the Economist's proposal, countries would agree to accept payment in units of account and would receive drawing rights up to an amount computed on the basis of their gross national product or volume of trade in a previous period. No specific provision is made for intra-union gold settlements, though some sliding scale arrangement of cash payments is envisaged for the early stages of the scheme. The Economist was free, therefore, to propose quotas that are very much larger than those under EPU. Since the problem of convertible resources for the union would hardly arise, the level of such resources does not set a limit to the size of the quotas. Specifically, on the basis of computation suggested by the Economist, the quota of the British Commonwealth would be around $50 billion and that of the United States around $35 billion. The object is to enable the union "to accommodate the surpluses and deficits of a long run of years."

Advantages of APU

An APU would have a number of clear advantages over the present system of payments. The first of these refers to the cooperation between national monetary authorities which would necessarily be strengthened by the establishment of an all-embracing clearing union. In a world where changes in political expectations can set in motion movements of capital too swift and extensive to be absorbed by foreign credits or reserves, full convertibility on current account can be operated only at the level of central banks. This in turn requires close cooperation among national monetary authorities in their control of undesirable capital movements, and the establishment of a clearing union in which all participate is a most effective means to this end.

A second advantage, and far more significant than the first, lies in the provision of what has come to be called "elbow room" for countries not otherwise prepared to risk relaxation of external financial controls. There is now fairly general agreement that an easing of discrimination requires enlarged financial resources in one form or another. But for countries to build up their own reserves will take considerable time. An APU of the type proposed would provide fresh financial resources immediately. Under the clearing union, generous swing credits are to take the place of convertible reserves or the facilities once granted to the rest of the world by sterling credit lines in London. It is clear that a system under which countries may have recourse to automatic credits -- the debit side of the quotas of the union -- would be vastly superior to one under which they are forced periodically to tighten their import restrictions, permit rate changes to bear the brunt of adjustment, or to deflate even if the disequilibrium was caused by external changes. But these advantages are features of a functioning union. They do not by themselves help to make it work.

An APU would have at least three further advantages, all of the kind which would tend to accelerate progress toward international balance and hence raise the prospects for a smoothly operating mechanism. In the view presented in this paper the short-comings of the scheme would outweigh these advantages. They are, nevertheless, essential elements of the answer to the question posed at the outset, namely, not whether an APU could function once equilibrium had been achieved, but rather whether its very establishment would promote balance in international payments.

The first and probably a minor advantage of this kind is the effect which convertibility within the clearing union would have on the prices of international commodities exported by hard as well as soft currency areas. Under present conditions of inconvertibility, the world prices of such goods at official rates of exchange are not identical irrespective of their source or the currency in which payment is made. Cotton when payable in soft currency fetches a higher price than cotton of comparable quality when payment must be made in dollars. The reason for the spread is the greater desirability of the convertible currency. To the extent that dollars are obtained in free or black markets at a premium, the spread between soft and hard currency commodities of this type is eliminated. To the extent, however, that control authorities grant dollars at the official rate for the purchase of these goods, dollar goods become cheaper than soft currency goods. And insofar as export proceeds in soft currencies are converted at official rates, exporters gain by selling to other soft currency countries rather than to the dollar area. The result is an incentive to import international staple products from the dollar area and to export them to soft currency areas. This disincentive from the point of view of reducing dollar deficits would no longer exist in a clearing union which includes the dollar area. The concentration of deficits on the United States and the resulting tendency towards exhaustion of the United States quota would therefore be correspondingly reduced.

A second feature of a comprehensive clearing union that might help to make it work is the clear emergence of over-all debtors and over-all creditors. In bringing to light the reasons for such disequilibrium positions, the over-all clearing mechanism -- so it might be argued -- would point the way not only to the internal policies required for their elimination but also to appropriate changes in exchange rates. This point may deserve brief elaboration.

In a regional payments union such as the EPU, excessive surpluses are not susceptible to correction by general monetary policy. Unless increases in dollar deficits are to be risked, surplus countries can assist in correcting their balance of payments position only by increased discrimination against the dollar area. On the other hand, membership in a regional clearing system, whether this be the EPU or the sterling area, may make it more difficult for member countries to improve their dollar position. The recognized need for solvency of the system or political considerations may exert a stronger influence on a country's over-all financial policy than its payment position with the outside world. The prospects for the right financial policies throughout the system might therefore be brighter in a comprehensive payments union. It is conceivable, for example, that, had Britain been running a deficit in a world-wide clearing union instead of with the dollar area, she would have found it easier to restore over-all balance than under the present system. With the Commonwealth countries operating as separate members of an APU, excessive imports from Britain would have threatened to exhaust their several quotas. With the Commonwealth a single member of the clearing union, outside pressure from the managing authority might have made it politically easier for Britain to reduce investment within the area, i.e., curb the flow of capital to the dominions and thus improve the Commonwealth's position in the clearing union by increased exports from the U.K. to the dollar area.

The clear emergence of over-all debtor and creditor positions does not facilitate not only the adoption of appropriate internal financial policies. It also permits independent adjustments of the rate of exchange. As long as a country participates in a regional clearing mechanism, the rate of exchange which would be appropriate to correct an excessive deficit or surplus within the regional union is not necessarily an appropriate rate for its financial and commercial relations with the outside world. The only solution to this problem would be to break cross rates, unless all countries within the union were to make an adjustment at the same time. This may not be possible. On the other hand, the disadvantages of a solution involving broken cross rates might be even greater than the disadvantages of maintaining the inappropriate single rate. The result is that no change is made. Under an all-embracing clearing union, these conflicts would not arise and each country would be free, within existing international agreements, to make the change it considers necessary in an effort to correct its over-all payments position.

Finally, there is the over-all economic advantage of a clearing union including the dollar area that lies in the restoration, albeit a gradual one, of non-discrimination in trade between what are now hard and soft currency areas. A variant of one of the arguments advanced in favor of the EPU prior to its establishment would seem to apply here. In other words, the stimulus that would be given to increased efficiency and a better distribution of resources by trade liberalization with the dollar area might so strengthen the European economy that it could successfully compete with the dollar area.

An APU, then, would set up within itself a number of forces that are likely to counteract the natural tendency, at least in the early stages of the scheme, toward exhaustion of the United States quota. And if the argument of Mr. Hersey's paper[1/] is accepted, the case for an APU is better than the Economist would seem to have been aware. It calls for extraordinary optimism to believe that a clearing union could operate under conditions of persistent dollar deficit in the order of $5.0 billion that is foreseen by the Economist, no matter how large the quotas of likely creditors. But it is not too difficult to visualize the possibility of fluctuations around an equilibrium in the order of $1.0 to $2.0 billion and hence a union that could function with quotas of reasonable size. To oppose the immediate introduction of an APU on the ground that the dollar problem has not been reduced to one of fluctuations around equilibrium -- see Mr. W. R. Sargent's letter to the Economist, December 6, 1952 -- would seem, therefore, to fail to do full justice to the Economist's proposal. True, the Economist could hardly have left itself more open than it did to the charge of inconsistency by insisting on the existence of an irreducible dollar deficit, which is clearly incompatible with a functioning clearing union. But the real point which, in my view, must be met is the implicit belief that the very existence of an APU would bring about the situation in which alone it could operate; that an APU, indeed, would lead to such a situation more effectively than other means to the same end.

Shortcomings of APU

Notwithstanding some tendencies inherent in the mechanism of an APU which would help to make it work, it is submitted that these tendencies are not strong enough to offset the forces operating in the opposite direction.

Consider first the side of the creditors. If deficits were to converge on the United States, large deposits would accumulate in its favor and these resources could be used to import more from the rest of the world. But this would not solve the problem. The United States has the resources now. It is true that an accumulation, under APU, of claims on other countries' resources may make the creditor position of the United States more obvious to the public. This would not, however, increase the demand for imports. Nor is it likely that an over-all expansionary policy would be followed unless these were a significant increase in unemployment. It is probable, of course, that if the United States were to enter an APU, such a step would be accompanied by greater liberalization of trade all around. And the increase in the export surplus of the United States might well generate an increase in the demand for all goods including imports. But these favorable effects might not be sufficient. Dennis Robertson, in another context, has put the point more subtly. "On the whole," he wrote

1/ "How large is the world's dollar deficit", Review of Foreign Developments. December 16, 1952.

in 1950, "it is doubtless salutory that Americans should do their international trade thinking largely in terms of income effects, as long as that does not corrupt Europeans into forgetting about price effects." All this does not mean that the United States could not or should not be expected to import more in the future in response to the widening demand for "trade not aid," even on this side of the ocean. It does imply, however, that an APU is not calculated positively to encourage such a development and that European policies, therefore, must continue to be designed to make more European exports competitive.

To discourage debtors from over-importing, the Economist's proposal relies principally on actions by the managing authority of the APU. "The proper way," writes the Economist, "to prevent [exhaustion of creditor quotas]... would be to bring big guns to bear on the internal policies of debtor countries." The first of these, though its supply of ammunition is to be limited, is an arrangement for intra-union gold settlements. Such settlements are to discourage debtors from permitting any undue increase in their obligations to the union. The Economist does not elaborate the point. Its inclusion, however, implies a compromise which detracts from the theoretical advantage of the scheme: the elimination of the dual monetary system, to use John H. Williams' phrase, which means that creditors would regard an increase in deposits in the union as of the same value they formerly attached to an equivalent receipt of gold. Moreover, any provision for intra-union gold settlements leads immediately to the troublesome question of convertible assets for the union, a problem to which the Economist has not provided an answer. But if cash settlements in some form are believed to be required, alternative systems, such as stabilization credits repayable in creditor currency may have advantages over a hardened APU.

It is, indeed, not the hardness of settlements but the influence of the union on debtors' internal financial policies which the Economist would regard as the most important weapon of an APU to correct excessive deficit positions. Instead of the famous language of the British paper of April, 1943: "There should be the least possible interference with internal national policies, and the plan should not wander from the international terrain," the Economist writes: "...if world trade is to be really freed, this has got to be done by giving an international body much more power over the internal economics of debtor countries than sovereign nations have hitherto been willing to concede."

As a last resort, the Economist implies, the union might withdraw its facilities from a debtor country that does not abide by the rules of the union. This provision may not be as strong a sanction as it appears. It would probably be recognized by all participants that the ill will that would be created by the application of this provision would make it very difficult for the union to resort to it.

The experience of the EPU provides a lesson with regard to the influence of a clearing union on the internal policies of member countries. It would not be fair to point to the failure of EPU to force upon the governments of surplus countries, such as Belgium and Portugal, the kind of changes in their internal financial policies which would have induced a greater volume of exports to these countries. A large part of the reluctance to expand was based, of course, on the fear of increasing existing dollar deficits.

The story is a different one on the debtor side. It would seem that a union's recommendations will be heeded as long as it can reward compliance with its recommendations with the provision of additional resources to the debtor. The cases of Germany in 1950/51 and of Turkey in 1952 are illustrations of this. If introduced now, an APU would presumably have to provide such additional resources in the shape of an increase in the largest creditor's quota. But if the union, at this stage at least, would tend to be burdened by an excessive creditor, would it not be better to recognize this probability rather than conceal it by stipulating quotas of a size likely to postpone progress toward equilibrium? In other words, however attractive would be the concept of an automatic quota as opposed to that of a credit from the point of view of multilateral cooperation, a quota -- especially of the type proposed by the Economist (presumably with a slow scale of gold payments) -- tends to be less of an incentive to rectifying action than a stabilization credit properly so-called, whether such a credit is to be provided by the International Monetary Fund or otherwise.

Stabilization credits

A brief commend on the Economists' view on stabilization credits would therefore seem to be in order at this juncture. First, a word as to their alleged effect of rewarding failure and penalizing success. The Economist would surely not level the countercharge of romaniticism against the present writer if he stated that, on the contrary, stabilization credits would be based on trust resting on past experience, trust in the sincerity of an effort to restore or maintain those conditions which alone make possible the use of the credits as intended. The objective would be to buttress the trust of third countries in the recipients' solvency so that they, in turn, would be willing to hold the currencies of these recipients. Second, on this side of the ocean at least, itis not at all clear that consensus of technical opinion would recommend that any future stabilization credit be once more made contingent on the full convertibility clause of 1947. Most would favor a gradual rather than a sudden dismantling of restrictions.

Conclusion

The main problem at this stage, therefore, would still seem to be one of reconciling two distinct requirements of international financial policy. The first of these is the need to provide more leeway for currencies about to become sufficiently strong for less discrimination to become feasible. The second is the need to devise a system of payments that is hard enough to prevent premature relaxation of disinflationary policies. A clearing union including a large United States quota, as proposed by the Economist, is only too well suited to meet the first requirement. Whether it would, as presently conceived, meet the second condition is extremely doubtful. And as soon as the possibilities are explored of modifying it to meet this weakness, alternatives come to mind which, on economic incentive grounds, would seem to be more effective, and on political grounds more acceptable.