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Yesterday Is Not Tomorrow — Effects of a U. S. Recession on the World Economy — 13 pages

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Yesterday Is Not Tomorrow — Effects of a U. S. Recession on the World Economy

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Memories of 1929, 1937 and 1949 are haunting the world of 1953. European statesmen, business leaders, and economists live in constant dread of a recession in the U. S. economy and of its effects on the rest of the free world. They do not dare to take decisive steps toward an expansion of investment and output, toward a relaxation of trade barriers against dollar goods, and especially toward a restoration of dollar convertibility of "soft" currencies: they fear that at any moment the hard-won internal and external balance of their economies may be shattered by another dollar crisis, which they believe to be the inescapable consequence of any impairment in U. S. prosperity. For years they have been told that a recession in the U. S. economy would be a catastrophe for the economy of the free world. No doubt, this thesis was true yesterday; but we may pause a while to ask us whether it is likely to be true tomorrow.

We need not discuss the question of whether the fear of a U. S. recession is justified at the moment. Even if it were unjustified, the existence of the fear would be a fact, and we could dispel it not by trying to preach the doctrine of eternal prosperity in the United States — which neither European nor U. S. business leaders would or should believe —, but only by analyzing recent changes in the relation between the United States and the world economy in order to find out whether a recession — if it actually should occur — would be likely to have the same effects on the rest of the world as, say, back in 1949.

It is the experience of 1949 rather than of earlier recessions or depressions that explains the European attitude. Europeans are quite ready to concede that the coordinated effort of administration and private business would prevent a recession from developing into a full-fledged depression, not only of the 1929-33 but even of the 1937-38 magnitude. However, they argue — rightly, in all probability — that it would be impossible, and from the U. S. point of view perhaps not even desirable, forever to avoid "normal" fluctuations such as those of 1949 — a movement that could hardly be called a genuine recession but was merely a temporary interruption in the continuous expansion of the U. S. economy. And they point out that even this almost imperceptible recession resulted in a decline in U. S. imports by about 10 per cent (see Appendix, Table 1), which was sufficient to disrupt the external balance of a considerable part of the free world and — together with the prevalance of price distortions and speculative capital movements — to force many nations to devalue their currencies.

Let us assume then that at some time in the near future a movement similar to that of 1949 develops, and that in consequence U. S. purchases of foreign goods and services decline in 1954 by, say, 10 per cent from the 1952-53 figure and remain at the lower level for about a year. Such a mild readjustment would probably not involve a significant drop in the price of manufactures and would therefore not imperil the competitive position of foreign exporters in third markets. Let us also assume for simplicity's sake that the decline in imports is about evenly distributed among our trading partners -- an assumption which would have to be dropped if the effects of such a recession were to be fully analyzed -- and finally, that the readjustment does not lead to a cut in the foreign assistance program nor to a serious resurgence of protectionist commercial policies in the United States.

Under these assumptions, the only direct effect of such a mild recession on the rest of the world would be a cut in foreign dollar purchasing power by about $1.7 billion annually. The thesis defended in the rest of this paper is that foreign nations are today far better prepared than in 1949 to take such a cut without serious repercussions on their internal and external economic condition.

Sectors of foreign economies affected by U. S. recession

The decline in dollar earnings that invariably results from a recession in the U. S. economy affects foreign nations primarily through the following mechanism:

1. The reduced availability of dollars may make it necessary or at least desirable for foreign nations to reduce dollar purchases.

2. This reduction in turn forces foreign nations to substitute more expensive or less adequate supplies from non-dollar sources, thus impairing their competitive position in the world market, or to curtail the output of industries depending upon dollar imports. At the same time, the level of activity in their export industries is depressed and these industries must seek alternative and less remunerative markets.

3. Finally, the reduction in supplies may tend to bring about inflationary pressures, or the reduction in export earnings may bring about deflationary pressures.

On the other hand, the effects of a U. S. recession will be minimized to the extent that the following conditions obtain:

1. Gold and dollar reserves are sufficient to tide a foreign nation over a temporary reduction in dollar earnings without forcing it to cut its dollar expenditures.

2. Supplies from non-dollar sources are not substantially more expensive or less adequate than those from dollar sources.

3. The domestic financial situation is so stabilized that moderate inflationary or deflationary pressures can be counteracted by moderate changes in monetary policy and speculative movements are unlikely to get out of hand.

In all these respects, the situation in 1953 is, for most countries, much better than the situation that existed in 1949 or earlier postwar years.

Changes in foreign gold and dollar holdings

On December 31, 1948, gold and dollar holdings of the free world (excluding the United States and the Bretton Woods institutions) amounted to $14,485 million. By June 30, 1952, the amount had increased to $19,122 million, and in the following twelve months it rose further to $21,375 million.

This rise in reserves has been well distributed among most of the important trading nations of the world, and has especially benefited those countries which had the most inadequate reserves in 1948, such as Germany, the Netherlands, and Japan (see Appendix, Table 2).

It can hardly be doubted that the impact of the 1949 recession on the European countries would have been very much slighter if at that time their reserves had been almost 50 per cent higher than they actually were.

More important still is the consideration that the rise of reserves between the middle of 1952 and of 1953 was substantially greater than the assumed decline in dollar availabilities resulting from a moderate U. S. recession. On a global basis, a reduction in U. S. purchases of foreign goods and services by $1.7 billion would still have permitted the foreign nations in 1952-53 to increase their gold and dollar reserves by more than $0.5 billion. Taken as a whole, the rest of the world would thus have had no need to decrease their dollar imports at all, without dipping into their existing reserves.

On an individual basis, this relation would obviously not be expected to hold. Under the — highly unrealistic — assumption that the cut in purchases were evenly divided among all major trading areas, the sterling area and the Continental European EPU area would still have been able to increase their gold and dollar holdings, but Canada, Latin America, and the rest of the world would have suffered some decline (see Appendix, Table 3). Moreover, within the various areas, individual countries would have had very different experiences: in Europe, for instance, Belgium, France, and Sweden would have lost reserves, while Germany and the Netherlands would have continued to accumulate reserves at a rapid rate.

Actually, a mild recession in the United States is likely to affect inventory accumulation more than the flow of finished goods to consumer; it is therefore likely to reduce imports of industrial raw materials more than those of finished goods, and among imports of finished goods those of capital equipment and luxury consumer goods more than those of non-luxury consumer goods. For these reasons, imports from the Outer Sterling Area and Indonesia (mainly raw materials) would be likely to suffer more than those from industrial countries and these imports in turn more than those from Latin America (largely foodstuffs). However, even under this more realistic assumption it would seem unlikely than any region would be hit so strongly that it would have to take drastic steps to reduce dollar expenditures in order not to suffer a sharp decline in reserves.

Moreover, as long as the decline in dollar availabilities was restricted to a few countries and did not spread over large regions, it would be possible to avoid bad repercussions by drawings from the International Monetary Fund, which after all was established to meet just such a contingency. The fact that the Fund — with gold and dollar resources of $3 billion — appears to be more inclined than in 1949 to permit drawings by member nations, should therefore have an effect very similar to that of a further rise in foreign reserves.

Changes in world prices and production

Even if some foreign nations were forced to cut their dollar imports significantly because of the drop in their dollar receipts, the consequences of such cuts upon their domestic economies would be much less serious than in 1949: price differentials between dollar and non-dollar goods have virtually disappeared, primarily as the consequence of increased availability of non-dollar products competitive with dollar commodities.

Raw materials and foodstuffs — Prices of the main U. S. agricultural exports (wheat, cotton, tobacco) were in 1948 very much lower than those of identical non-dollar goods; in 1953 there is almost no price differential (see Appendix, Table 4). All these goods are to-day in ample supply; foreign customers of the United States will therefore have little or no difficulty in switching from dollar to non-dollar sources of supply for these goods.

The clearest evidence of the disappearance of premium prices for non-dollar commodities is the reopening of free international markets for some important staples, first in the United Kingdom and most recently also in the Netherlands. This development makes it impossible for traders in the market to distinguish between dollar and sterling commodities, and thus helps to make the world more independent of the supply of dollar goods.

Finished products -- In manufactured goods, foreign dependence on U. S. exports during the early postwar years was probably based as much on differences in delivery dates as on price differentials. Direct statistical evidence for the improved position of the competitors of U. S. exporters in 1953 may be difficult to gather; however, the rise in foreign production and foreign exports of such products clearly indicates growing competitiveness of non-dollar exporters (see Appendix, Table 5).

The improvement in the foreign position has been most pronounced in the case of Germany and Japan. Largely on account of Germany's progress, the aggregate industrial production of the OEEC countries in the first half of 1953 was almost 45 per cent above 1948 -- the period preceding the last recession -- as contrasted to an increase of 25 per cent in the United States. Total exports from the OEEC countries and Japan rose between 1948 and the twelve months ending June 30, 1953, from \$17.1 billion to \$27.3 billion while total U. S. exports (excluding "special category" goods, i.e., munitions) fell from \$12.7 billion to \$12.0 billion.

Finally, there are indications that most foreign industrial nations have unutilized reserves of manufacturing capacity and manpower. Increased demand for manufactured goods from dollar to non-dollar sources could therefore be satisfied without difficulty by further expanding industrial production abroad. Under these circumstances, it is possible that any reduction in U. S. imports and exports would largely mean a shift rather than a reduction in total world trade: reduced U. S. trade might be compensated at least in part by increased trade among non-dollar nations. In view of the improved competitive position of the non-dollar nations, such a shift could probably be accomplished by moderate price readjustments without requiring an increase in discriminatory import restrictions against dollar goods.

Changes in financial stability

The financial impact of the mild U. S. recession of 1949 on the rest of the world was due primarily to inflationary pressures, which at that time were still rampant in a great part of the world.

In a country suffering from inflationary pressure, the balance of payments is almost invariably in a state of chronic disequilibrium. The slightest deterioration is likely to produce a crisis. Moreover, if the reduction in dollar exports has deflationary consequences within the sector of the economy depending on such exports, it is almost impossible to take expansionary countermeasures without further increasing the inflationary pressures throughout the economy. Similarly, a reduction in imports, with its inflationary side-effects, again tends to reinforce the inflationary pressures and thus to counteract in part the equilibrating influence of the import reduction on the balance of payments.

In a country with stable financial equilibrium, a recession in dollar export industries can be fought without danger by expansionary policies, and any inflationary impact of import reductions can be offset successfully by mild disinflationary measures.

While it is difficult to measure directly the degree of inflationary pressure, a comparison of price developments shows that most major non-dollar trading nations for which data are available -- except only Belgium, Mexico, Italy, and Sweden -- were suffering from considerable pressure in 1948-49, while in 1952-53 such pressure seemed present only in Brazil, Argentina, Australia, and Turkey (see Appendix, Table 6). Moreover, this method underrates the improvement in recent years: in 1948-49 the use of direct controls, indicating the existence of repressed inflation, was far more pervasive than in 1952-53.

Finally, many countries that in 1948-49 no longer experienced strong inflationary pressures, still suffered from the aftereffects of inflationary movements in the preceding postwar years, which distorted their price and cost relations. These distortions made their currencies vulnerable to speculative capital movements and were thus as instrumental as the U. S. recession in generating the devaluation wave of 1949. With very few exceptions, the major trading nations appear at present to be free from such distortions.

Particularly important in this respect is the attainment of financial equilibrium in the United Kingdom. In view of the wide-spread use of sterling in international transactions, the stability of sterling -- which in turn depends upon the achievement of internal financial stability in the United Kingdom -- is second in importance only to the stability of the dollar as a prerequisite of stability in international economic relations. Today, sterling has regained a strong international position, as evidenced by the virtual elimination of "cheap sterling" transactions, the reduction in "blocked" sterling balances, and the facilitation of currency and commodity arbitrage in sterling. This improvement, due among other things to the devaluation of 1949 and the monetary policies followed by the U. K. authorities since the fall of 1951, might make it possible for sterling to become again the leading world currency if anything should happen to lessen the usefulness of the dollar as an international means of exchange.

Conclusion

It must be remembered that such an optimistic view of the effects of a possible U. S. recession on the economic position of foreign, and in particular European countries, can be justified only on the basis of our fundamental assumptions, first, that the recession would be not worse than the U. S. readjustment of 1949, and second, that it would not be accompanied either by a sharp reduction in U. S. Government expenditures abroad, nor by a return to protectionist economic policies in the United States. Moreover, it must be assumed that appropriate policies would be adopted by the International Monetary Fund as well as by the individual major nations involved in the development.

If, however, these assumptions appear realistic, it would follow that the prevailing fears of the consequences of a mild U. S. recession might well be exaggerated. In fact, these fears might hurt the world economy more than a recession itself. European political and economic leaders would therefore have little reason to allow these fears to delay measures that would increase production and consumption and encourage the freeing of international trade and payments.

STATISTICAL APPENDIX

(Prepared by Frederick R. Dahl)

APPENDIX

Table 1

U. S. Imports

(In millions of dollars)

	1948 July - Dec.	1949 Jan. - June	1949 July - Dec.	1950 Jan. - June
United Kingdom	145	112	115	126
Belgium-Luxembourg	63	55	39	59
France	40	31	31	41
Italy	50	35	36	41
Netherlands	28	27	32	26
Germany	21	28	18	32
Sweden	36	24	31	36
Other Europe	197	162	151	185
Total Europe	580	574	453	546
Canada	889	761	790	882
Latin America	1,114	1,174	1,127	1,284
Japan	37	42	40	74
Outer Sterling Area	518	512	412	560
Rest of World	466	428	411	474
Total	3,604	3,391	3,233	3,820

Source: U. S. Department of Commerce

APPENDIX

Table 2

Gold and Dollar Holdings

(In millions of dollars)

	December 31, 1948	June 30, 1952	June 30, 1953
Canada	1,221	2,396	2,238
United Kingdom 1/	2,151	2,218	2,861
Belgium-Luxembourg	772	821	830
France	741	847	881
Italy	424	615	657
Netherlands	289	547	883
Sweden	130	281	280
Germany	179	545	893
Other Europe 2/	3,259	3,996	4,483
Latin America	2,744	3,301	3,664
Japan	287	849	1,015
World 3/	14,485	19,122	21,375

1/ Partly estimated.
2/ Excluding Soviet Bloc countries; including B. I. S. holdings.
3/ Excluding gold and dollar holdings of U. S., Soviet Bloc countries, I. M. F., and I. B. R. D.

Source: Board of Governors of the Federal Reserve System, Federal Reserve Bulletin.
International Monetary Fund, International Financial Statistics.

APPENDIX

Table 3

Effects of a Hypothetical Decline in Dollar Expenditures on Foreign Reserves

(In millions of dollars)

	Gross dollar receipts 1/ July 1952 - June 1953 (a)	Change in gold and dollar holdings July 1952 June 1953 (b)	Hypothetical 10 per cent decline in dollar receipts (c)	Remaining change in reserves (b - c)
Continental Western Europe	3,395	+ 1,255	340	+ 915
Sterling Area	2,804	+ 643 2/	280	+ 363
Canada	3,129	- 158	313	- 471
Latin America	4,411	+ 363	441	- 78
Rest of World	3,220	+ 150 3/	322	- 172
Total	16,959	+ 2,253 3/	1,696	+ 557

1/ U. S. imports of goods and services, private gifts, and government unilateral transfers exclusive of military and economic aid.
2/ Change in gold and dollar reserves of United Kingdom
3/ Excluding U. S., Soviet Bloc, I. M. F., and I. B. R. D.

Source: U. S. Department of Commerce, *Survey of Current Business*, Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*.

APPENDIX

Table 4

Prices of Dollar and Non-Dollar Agricultural Commodities

(In U. S. currency units)

	1948	January/ June 1953
Wheat ($ per bushel):		
United States	2.41	2.30
Australia	2.99	2.38
Cotton (cents per pound):		
United States	33.8	32.9
Egypt	61.3	36.0
Tobacco (cents per pound):		
United States	44.4	50.0
Turkey	58.8	51.3

Source: International Monetary Fund, International Financial Statistics

APPENDIX

Table 5

Industrial Production and Exports of Manufactured Products

	Industrial production 1953 - 1st half (1948 = 100)	Exports of mfd. products 1948 (In millions of U.S. dollars*)	1953 1/
United States	125	8,464	8,324 2/
Canada	126	769	1,132
United Kingdom	121	5,533	6,068
Belgium-Luxembourg	115	1,101	1,364
France	130	970	1,582
Netherlands	138	445	938
Germany	242	106	2,992
Japan	269	190	914 3/

* Converted into U. S. dollars at official rates of exchange.
1/ First half-year at annual rate.
2/ Excluding special category goods.
3/ Partly estimated.

Source: International Monetary Fund, International Financial Statistics.
U. S. Department of Commerce, International Trade Statistics Series.
Canada: Dominion Bureau of Statistics, Canadian Statistical Review.
United Kingdom: Central Statistical Officie, Monthly Digest of Statistics.
Belgium-Luxembourg: L'Institut National de Statistique, Bulletin de Statistique.
France: Institut National de la Statistique et des Etudes Economiques, Bulletin Mensuel de Statistique.
Netherlands: Centraal Bureau voor de Statistiek, Maandstatistiek van de in-, uit - en doorvoer per goederensoort.
Germany: Statistisches Bundesamt, Aussenhandel der Bundesrepublik Deutschland.
Japan: S. C. A. P., Japanese Economic Statistics. Economic Council Board, Japanese Economic Statistics.

APPENDIX

Table 6

Change in Wholesale Prices

(In per cent)

	1948 to Jan.–June 1949	Jan.–June 1952 to Jan.–June 1953
Japan	+ 54	0
Argentina	+ 31 1/	+ 5
Germany	+ 20	– 3
France	+ 10	– 5
Turkey	+ 10	+ 2
Australia	+ 9	+ 3
Brazil	+ 8	+ 11
Netherlands	+ 5	– 5
United Kingdom	+ 2	– 1
India	+ 2	0
Sweden	+ 1	– 6
Italy	+ 1	0
Mexico	– 1	– 4
Belgium	– 3	– 9

1/ Cost of Living in Buenos Aires, average 1949.

Source: International Monetary Fund, International Financial Statistics