# EMPLOYMENT, GROWTH, AND PRICE LEVELS

# HEARINGS

BEFORE THE

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## CONGRESS OF THE UNITED STATES

EIGHTY-SIXTH CONGRESS

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STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS

(Pursuant to S. Con. Res. 13, 86th Cong., 1st sess.)

OTTO ECKSTEIN, *Technical Director*
JOHN W. LEHMAN, *Administrative Officer*
JAMES W. KNOWLES, *Special Economic Counsel*

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MONDAY, JUNE 29, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to notice, in room P–63, the Capitol, at 10 a.m., Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Sparkman, and Bush; Representatives Bolling, Coffin, and Widnall.

The CHAIRMAN. Gentlemen, the hour of 10 o'clock has arrived, and Mr. Diebold is ready. I think we can proceed.

We are very glad indeed to have you here, Mr. Diebold, and we appreciate your coming. We are starting this week, as you know, a series of hearings in international influences on the American economy. We are under constant pressure to impose tariffs and import quotas upon various commodities, and have in fact done so. The charge is also being made that American goods are being progressively priced down in the world market because of high pressure groups here at home.

These are only two of the many questions which we would like to explore this week, and we are very glad to welcome you as the initial witness. The other members of the committee are coming along in just a few minutes, but I think we should not wait for them, but should proceed.

Once again I wish to welcome you and say we are greatly interested in your testimony.

## STATEMENT OF WILLIAM DIEBOLD, JR., DIRECTOR OF ECONOMIC STUDIES, COUNCIL ON FOREIGN RELATIONS, INC., NEW YORK CITY, N.Y.

Mr. DIEBOLD. Thank you, Senator Douglas.

I should make it clear at the outset that I speak only for myself. I am director of economic studies at the council on Foreign Relations in New York. The council is a private nonprofit organization that takes no position on matters of public policy, and anything I say is said only in my private capacity.

You asked me to submit a written statement, which I find is somewhat too long to read in the half-hour that you have allotted me, so if it is agreeable to you, I will go through the statement, staying within that time limit, calling attention to the main points that are made in the statement, rather than attempting to summarize it in any greater detail.

As I understand the purpose of this morning's session, it is to provide an introduction for the more specialized sessions you will be having during the next 3 days. The request you made of me was to survey broadly the position of United States in the world economy in order to open up the more specialized studies of the common market, undeveloped areas, et cetera, that will be coming up.

I found this, frankly, difficult to do with any kind of balance. I have as a result come out with a statement that, I think necessarily, is very general in its tenor. I am not trying to persuade you to one or another course of action. I do not have a single, monistic explanation of things which would make it possible to organize all my remarks around it. To cover as much ground as possible, I have avoided statistical demonstrations, and I have not tried to work out a series of projections. Rather, I have called attention to clusters of problems that seemed to me likely to be with us for a number of years to come, looking beyond what may happen in the next 6 months or even the next year.

In a way, this is a framework for further investigation more than it is a clear and concrete statement of where we stand.

I think it is necessary to start something of this sort by looking at the fundamental political and strategic position of the United States. I think you can make a long catalog of the factors in the world economy that influence the U.S. economy and still not come to anything that is as influential as the basic political position.

In this respect one needs only look at the level of arms expenditures in the United States, the Soviet Union, and the rest of the world, or the number of resources of all kinds that have to be put into military endeavors. It is therefore clear that any major change in the political and strategic relations of the world will have important consequences on the American economy.

After all, a 10-percent change in our military budget is equal to our total foreign aid budget, and a 5-percent change is equal to our nonmilitary budget. But even if there is not a great change in the political relations, even if we assume a continuation of the cold war—and the necessity to maintain maximum military preparedness—there will still be major economic effects, because as I think we have seen in the last 15 years, changing military technology can spell the rise of one industry and the fall of another; it can change the importance of patterns of trade, of domestic production, and even of the attractiveness of investment opportunities abroad.

I am in no position to judge the effect of changes in strategy or military technology on the budget. There is a tendency in some quarters to believe that the military budget can be reduced because the striking power is now so concentrated. But if one were to accept the recommendation that we be prepared to fight conventional wars all the way around the world, and this would not be a substitute for maintaining a nuclear deterrent but an addition to it—so far as I can see—there is at least as likely a development of larger military budgets than smaller ones, given no disarmament and no war.

Another element in basic American-Soviet relations that affects our economic policies is our growing concern with the relative rates of growth of the two countries. You have a subcommittee that is working on this problem. I think I can add nothing to it at this point. I would only say in passing that it is important, it seems to me, since we shall have this problem with us for a long time to come, that we sharpen our concepts of growth and that we get a little clearer than I think we always are about the relation of economic size to political and military strength.

I think also that, important as the comparison of American and Soviet growth is, we need always to bear in mind that we are only in a position to influence one side of that equation in any major fashion, but that our side of the equation involves not only the United States but large areas of the non-Soviet world that have great growth potential.

Also, the issue of growth is not just a matter of a race with the Soviet Union, and we need therefore to see problems of American eco nomic growth in a broader setting as I think we mostly do.

This brings us to the most recent development in Western and Soviet relations, and that is the increased use by the U.S.S.R., and to some extent China, of aid and trade as a weapon of foreign policy. So far, the activities of the Communist countries have been fairly limited. They have gained a good bit of success by concentration in certain areas where they are now formidable. They have gained a certain amount of political success simply by coming into a field where there already was extensive Western activity, which had inevitably developed certain frictions and other difficulties which the Soviet policy is designed to exploit.

There can be a good bit of argument as to how far and in what direction these policies on the Soviet side are likely to go. I think it is perfectly clear that they have the capacity to expand their activities of this sort quite a great deal. They may not. After all, they have not expanded them as rapidly since this program began as many people thought was likely 2 or 3 years ago. However, I think the only safe assumption in considering the future problems of the American economy is that this Soviet program will expand, and therefore we have to give our attention to a whole series of questions concerning, among other things, the relation of American aid to Soviet aid, the difficulties that may exist of enabling the underdeveloped countries to take advantage of this aid—which, after all, is perfectly real in most cases—while at the same time safeguarding themselves against the pressures that may go with it and against dependency on the Soviet bloc.

Finally, in terms of East-West relations, I think we are going to have to reexamine once more a problem that has given us quite a few headaches since the end of the war; that is, direct trade between Western Europe, Japan, and perhaps also the United States, and the Soviet bloc. So far as I can see, this is developing in Western Europe. It is not developing very rapidly in Japan, because it is all tied up with difficult political problems. I do not see that the development of this trade is likely to be of decisive economic importance to the United States, but I think we shall find that if the Western European countries engage in it more fully American producers and exporters will quite naturally raise questions about their possible role. I think therefore that we need to consider what the conventional distinctions between the strategic and nonstrategic goods mean in the present setting; whether it is of importance to Soviet growth that this trade goes on; what, if anything, the Government ought to be doing about it on political grounds.

If I turn now to a second wide area of problems, those connected with the underdeveloped countries, I can only touch on a few things, leaving to your later sessions such problems as the rate of private investment, the relation of private and governmental action, and the knotty problem of population growth.

Under this heading I would call attention first to what I think are two basic points. One is, it appears to me that within the last few years this country has reached the point of coming to accept the fact that, one way or another, it will be involved in the processes of economic development around the rest of the world for a long time to come. We, therefore, need to reexamine the way we approach this problem and our machinery for handling it. A good bit of what we have done has been done on the assumption that we were involved in a shortrun activity, or was even improvised to meet particular circumstances. I think we need now to look and see whether we are well equipped for the long haul.

At the same time, I think the words "economic development" sometimes confuse us. They are, after all, shorthand for a very wide range of problems, and the problems are not only those of lack of development; they are often those that come with the acceleration of development. I think some of the worst problems that are being faced in some of the countries of Latin America are due to the inflationary pressures, the balance-of-payments difficulties, and the like, that come when growth speeds up, not from slowness of growth which we find elsewhere.

I think from this it follows, if I am right on these two points—that we are dealing here with changing problems and a great complex of problems which will continue for a long time—then we require a broad base for whatever kind of aid or other activity the Western World undertakes, a wide range of instruments and devices at our disposal, and an understanding which permits us to make full use of them and not an approach in terms of formulas or with the belief that a sharp and massive effort for a few years will solve the problem.

I think there have been some favorable developments recently in this regard. I think the increasing use of the Development Loan Fund, the efforts to use the International Development Authority talks to bring the Western European countries more fully into the picture, the combination of activity by international agencies and American agencies and European agencies in a series of cases, are all very promising developments in this respect.

I think the other side of this, a matter which we often leave out when we talk about economic development, is that aid is only a piece of the problem. The largest part of development has to be done by the people in the underdeveloped countries. One of their main assets is the ability to export. I think that in our own trade policies and those of Europe, a greater consciousness of the relation of the export of raw materials to economic development is necessary.

In this regard, there are some things, such as technological change, which obviously are not primarily matters of policy. I note that rubber, silk, and tin, which used to make up 50 percent of our imports of raw materials, were less than 20 percent last year. We actually import less of each of these materials, with our greatly expanded economy, than we did 20 years ago. You cannot dictate technological change according to the needs of underdeveloped countries, but you can at least have a look at what is likely to happen and prepare for some of the consequences.

I need only mention in passing, raw material protectionism in the United States. The issues that have come up there are too complex to go into in general terms, but I argue only that they are part of the economic development problem as well as part of the problem of the domestic economy.

This leads to the whole question of raw materials stabilization. I have in my paper raised a few questions that indicate the complexity of this. I would say that it is important to realize that this is not something about which the economists are fully agreed as they sometimes seem to be on certain other issues of public policy; if there were no political difficulties, I do not think the economists would be able to rush in with pat solutions. It is a very troubled area of analysis: how you deal with shortrun fluctuations without distorting longrun indicators, how you in fact stabilize instead of just putting a floor under things and getting surplus stocks which cannot be disposed of on a rising market because of political pressure—a whole series of problems of that sort make this difficult.

I think it is important that the mátter of stábilization be given close and continuing attention. I think it is good that American policy within the last 2 years has shifted away from a negativism about this, which had reasonably good intellectual grounds but was a poor diplomatic posture, in that these problems were very urgent for a number of countries. It makes a good deal more sense to explore possibilities with them rather than to say, "Well, we have thought it through and it does not work." Because there are, after all, many possibilities of emergency action even if there are no satisfactory longrun solutions.

I think in looking ahead we had better bear in mind that it is not only raw matérials that underdeveloped countries export. The manufacturing industries of a number of these countries are expanding reasonably rapidly, particularly in such fields as textiles. Some of them are already exporting to neighboring countries, a few to wider markets. It cannot be very long, I think, before we will find larger quantities of Indian and Pakistani textiles, for instance, and other goods as well, being offered on world markets. The basis of a good bit of this kind of export will, of course, be low wages which will prevail in the underdeveloped countries for a long time to come. We therefore need to look ahead to a series of problems, not only for the United States but for Western Europe, comparable to those which we have had with regard to Japanese goods for a number of years.

I do not feel we have gotten awfully far in solving the problems of providing a lasting solution to the Japanese trade problems, but I can only suggest that we will have these somewhat multiplied. I am not talking about next year or the year after, and I cannot put a number on this, but, say, over a decade, I would think that we could expect to see more difficulties of this sort.

If we turn away now from the underdeveloped countries to the problems of Western Europe, the broad picture is by now a familiar one: a very great improvement in the European economy. It is very different from what it was 10 years ago. We are now 14 years after the end of the war; 14 years after the end of the first war was 1932. The picture is very different indeed from that one. The measures of convertability adopted last year fall short of complete convertability, but are still sort of a crown, to the degree of development and prosperity that is something new for Europe.

Some of the consequences of this of course, are found in the competition that American exporters have met in various world markets, this is in part the result of the revival of Western European production. The gold that has flown out of the United States has ended up in Western European reserves. This is one of the signs of European improvement that I mentioned. As a longrun matter it looks as if it were a gain for all concerned, because it seems to me that the more the problems of Europe can be regarded as problems that are solved by more or less normal methods and by adjustments that are not emergencies, the more likely it is that we shall be able to deal with the continuing problems in the rest of the world more effectively and on a more nearly joint basis with the countries of Europe.

I have already mentioned the drawing-in of the European countries to the processes of aiding underdeveloped countries. They are already doing a good bit. It looks as if they could do more. This is certainly a desirable direction for events to move.

The next problem that comes up is whether this increased ability of the Western European countries to meet financial burdens means that there should be a reexamination of the relative shares of Western Europe and the United States in meeting the various military bills for, at least, Atlantic strategy. This obviously raises problems going far beyond my competence and far beyond economic policy, but I think the evidence is at least that the question should be raised and examined.

This suggests a whole line of problems concerning defense economics and the extent to which our economic policy is to be determined by defense consideration. Part of the question is what we mean nowadays by talking of the defense essentiality of an industry. To what extent can this be judged entirely on a national basis? The familiar issue of trying to draw a line between Canada and the United States on strategic grounds for raw materials when you do not draw it for air defense is, I think, a fairly obvious one, but the problems are broader than that. I have mentioned some of these in the paper. There is, I think, no time to run through them in greater detail.

Along with the improvement in the European economy has gone a change in shape; that is, the creation of the Common Market. The first year of the Common Market has been surprising in the sense that, so far as I can see, business reaction has outrun the stimulus of the initial changes. In many fields businessmen appear to be acting as if the full Common Market were virtually going to be in effect next year or the year after, rather than in the 15 years or so that the schedule would permit. This raises interesting questions as to whether we may in fact see a speeding up of the processes of creating the Common Market in Europe.

For the United States, there are obviously immediate problems; that is, direct problems. They are not very pressing immediately, but they have to be tackled immediately if one is to deal with them—of the level of the European external tariff and of the effect on American exports of the creation of the Common Market. If one believes that the Common Market will contribute substantially to European growth, then the tariff issues will fall into second place. But they are still there.

In the interest of both promoting American exports and of working out the best pattern of allocation of resources between the United States and Western Europe there should be effective tariff bargaining on these matters. The Europeans have indicated that they are interested in this. I get the distinct impression that how serious the results will be depends, first of all, on the United States.

The problem of the free trade area I assume you will get into later this week. It raises troublesome issues as to the interest of the United States in a broader area of low tariffs in Western Europe versus a spread of the various forms of discrimination against American exports that are inherent in this kind of an arrangement.

The CHAIRMAN. Did you say that the creation of a free trade community would increase discrimination against American exports?

Mr. DIEBOLD. I meant this: That if a free trade area is created according to the original British proposal, this enlarges the area within which there are no trade barriers, but it also enlarges the area, the size of the market, in which American goods are outsiders' goods as opposed to insiders' goods. In other words, American exports to Britain will not be treated in Britain are German exports are if there is a free trade area.

The CHAIRMAN. Then the absolute tariff against American goods would not be increased?

Mr. DIEBOLD. Presumably not, if the original proposal for a free trade area were adopted. But as nearly as I can see from following these proceedings, the chances are at least as good of something that does not conform to the original British proposal of a simple free trade area, but that instead creates a series of special arrangements. Something will have to be done about the relation of the Commonwealth to the free trade area and there may be special treatment for certain goods.

As I say, the United States has to strike a balance between avoiding the splits in Europe that might come about if there were no agreement and deciding whether the pattern of agreement, if it is a compromise agreement, is in fact damaging or advantageous. This actually is a similar problem to one I think we shall face elsewhere in the world over the next 10 or 15 years. There is a growing interest in regional arrangements. I do not think that the European pattern can be followed very closely in very many parts of the world. I think in the underdeveloped parts the gearing of regionalism to investment and to development is apt to be much more important than simply the removal of trade barriers and the creation of payments arrangements. Therefore, some of the dirt problems that we face in Europe may not come up. But very rarely is this kind of regionalism based on simple economic logic. These are not usually problems for which a region is a natural area. It is a pragmatic argument that usually dominates. If these countries can, by getting together, move further ahead in arranging for a better allocation of resources than they can either individually or if you wait for a global agreement, then some kind of regionalism makes a lot of sense.

But I think it is important that we also maintain a perspective on these things which tries to fit whatever regional arrangements are developed into a set of rules that look at it from the global point of view, just as the GATT rules established certain limits as to what can be done in a common market or free trade area. Not only the rules but the processes of examining these things initially and then periodically thereafter in a global form seem to me of considerable importance to avoid the kind of distortions that otherwise can come about if it is always possible, within a regional organization, to make compromises by throwing the burden on the outsider.

There are problems, of course, of how far the United States should be involved in any of these things. The Inter-American Development Bank is an initial case. I do not think there will be many such cases, but there are problems that need to be thought about there.

I would conclude only by saying that I have obviously left out as much as I have put in, and I do not think this kind of survey lends itself to the drawing out of anything that one can even call a conclusion. Perhaps I have said enough to indicate that there is a great amount of change going on in the world which has a direct effect on the American economy; that some of the mainsprings of this change are outside the United States so that consideration of the impact on us must be added to the familiar story of the impact of American changes on the rest of the world; that we can influence the course of events quite a lot in many cases, but there are very few instances in which we can in fact control them by our policy.

We are faced with a series of decisions regarding economic development, regarding regionalism, regarding East-West trade and other things. Apart from those in which power-political issues of the East-West sort dominate, these decisions tend to have in common the fact that one course is the course of economic adaptation and flexibility and the other course is that of rigidity and the preservation of an existing pattern.

It is not possible to judge all these things in general but I should think that in most cases the course of flexibility is the one which combines our own economic welfare, seen in long-run and general terms, and the strengthening of our foreign policy interests. The line of flexibility is apt also to be the one that strengthens the whole free world economy and not just that of the United States.

I think these are very familiar principles for Americans. I think we all know that one of the main strengths of the American economy has always been its flexibility, and in fact we accept remarkably large shifts and changes in the domestic economy over the years from all sorts of factors without seriously trying to impede them. But we have not often applied these rules as easily to our foreign economic relations—partly, I am sure, because of the traditions; partly simply because of the high visibility of the problem when it crosses an international line. For instance, the tariff looks much more important to certain industries than it really is compared to domestic changes from, say, competing products or regional shifts within the United States. But it is visible and a target is offered, so to speak, which is not offered in our conventional thinking about internal matters.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

The discussion will be opened by Congressman Bolling.

Representative BOLLING. Yours is a very interesting paper, Mr. Diebold.

I agree, I think, with virtually everything you said as to the problems that we have ahead of us, not short-run but long-range. In thinking about many of them over the last several years, I have come to a tentative conclusion that perhaps neither the executive nor the Congress are organized in such fashion best suited to meeting this complex of problems in a consistent, anticipatory planning way.

I wonder if you would care to comment on the problem of structure—the way in which various aspects of the economic problem are handled by compartments of the executive, and by compartments of the Congress. In meeting a complex of different difficult problems, is it not necessary somehow to create institutions and government that deal with the problem as a whole, as on occasion the Joint Economic Committee attempts to do? This committee is unique, having a broad overall purview, but even that is of limited impact on planning since we do not have any legislative authority.

Mr. DIEBOLD. I am some distance away from firsthand familiarity with how the executive branch works in these things. The problem certainly was fully recognized in the latter part of the war and the early postwar years. Efforts were made within the executive to work out through a structure of interdepartmental committees, and so on, this kind of joining of the complex issues.

Like any committee, those had their difficulties, but it seemed to me that this was a rather good approach.

I am always a little hesitant to take a firm stand on any kind of an organizational change when I have not been fairly close to the problem, because it has been my experience that what an organization looks like on paper, or from the outside, may not be the way it works, and that some that look fragmented work rather well, and some that look neat are fragmented inside. So I do not have a clear view on whether a new department, new committees, or anything of that sort would be the best way to do this.

I do agree entirely with your fundamental point that we are now handling not only a wider range of things, but that the conventional range of things we handle have wider impact, simply because the American economy is such a large part of the world economy that issues that we used to be able to decide on strictly internal bases now have foreign repercussions. We can choose to ignore them if we wish, but we at least ought to know that they exist.

I did mention that our machinery for dealing with economic aid to the underdeveloped countries was due for reexamination simply because it had been put together by a series of separate decisions. If my view is correct that we are engaged in this now for a long time to come, I think we want to be sure that either we have specially designed machinery or we have succeeded in adapting the old, which we do fairly easily in our system sometimes.

On the other hand, I have been a little worried about some of the recommendations people have made for unified and simplified aid administration, because there tends to be also an adoption of certain limiting criteria. I think that one or two criteria are almost bound to be too narrow for the problem, and that we are therefore in the position of either depriving ourselves of useful instruments or of falsifying what we do by saying it falls under this set of standards, when in fact it does not. I think we need a variety of means of giving foreign aid. I think when, for instance, aid to Turkey comprised about four different kinds of American aid and three different kinds of international aid, this was good adaptation of existing machinery. I am sure it took a lot of work, but it is this kind of consideration which makes me hesitate to come down flat for any kind of organizational proposal I have not been closely involved in.

Representative BOLLING. I am, of course, not ready to come out flatly with any kind of organizational proposal. My basic point was really somewhat negative. If I understood what you were saying, it was that we were going to have to plan for longer periods of time than has been done in the past and that our present institutions were not established for such long range planning; that this planning involves a series of different types of economic problems, all of which are basically interrelated and effect each other; and that, to a very considerable degree, our control of this situation is getting less and less. Our precision will therefore have to be greater and greater if we are to be effective.

The question I was raising was, in effect, whether our present structure was sufficiently coordinated and adapted to long-range planning to be adequate to the increasing need. One of the elements in answering this question must be to ask the question whether the institutions that now exist are adequate to meet his kind of an overall situation?

Mr. DIEBOLD. I would certainly agree with that.

Representative BOLLING. That is all, Mr. Chairman.

The CHAIRMAN. Senator Bush.

Senator BUSH. Mr. Diebold, do you feel it is advisable for the United States to make tax concessions to encourage foreign investment?

Mr. DIEBOLD. I think I did not say orally, but I said at the beginning of my written statement that I hoped you would not expect me to take positions on bills that were currently up, with the kind of quick review I was able to undertake for this purpose.

I have been interested in the whole question of tax concessions. I feel that concrete proposals that are before the Congress require a more careful statement that I have been able to prepare for this session. On the general problem of tax concessions for private investment abroad, I have followed a reasonable amount of the discussion, but I have not studied it closely, and I believe I am far from clear whether we really can expect a major increase in what is done in the volume of investment by this method.

If we can, then I think there are pretty good arguments from the point of view of the usefulness of private investment both to foreign policy and to the development of the free world economy so that such measures make reasonably good sense.

I have been a little puzzled by some of the arithmetic that I have read in connection with these discussions, and I simply am not clear on it. To go to many parts of the world, an American company must find a higher rate of profit than it finds either at home or in another part of the world, not merely because of political risks, but because of all the complications that are involved in working in strange places. Therefore it is logical to suppose that measures affecting profits may have some results.

Senator BUSH. We are beginning to run into political problems with American investments abroad, who are manufacturing goods and shipping them back into this country. I wondered if you had any comment to make about that particular problem that we face.

Mr. DIEBOLD. No, except that it seems to me that this is a natural line of development for the American economy. That is to say, if the private businessman judges that this is the pattern of activity that conforms best to his needs, he ought to pursue it. After all, if he buys a component from a foreign producer or if he becomes a foreign producer of his own components, this is in some respects very similar. I would not say he ought to be barred from buying something abroad if that is more advantageous, and therefore I think it is fairly hard to say that he should be hampered in producing abroad.

I have suggested in my written statement that one aspect of private foreign investment that has not been as fully examined as it should be is the relation it has to American exports and American imports. We are familiar with the fact that a large proportion of private investment abroad is geared to producing raw materials for American needs. This development you mentioned of producing manufactured goods abroad for the American market is one of a series of related things that give me a sense that the role of private foreign investment in the whole American process of production and consumption needs a closer investigation than it has had. I think that it is related, too, to our concepts of the American economy which needs to be broad enough to include the part of the economy that functions outside the frontiers.

Senator BUSH. Let me come down to a little more specific problem. The problem of exports and imports is a real problem. We want to encourage exports all that we can, and I think we would like to encourage imports as much as we can without adversely affecting in toto the growth of our country and our employment factors.

Do you believe in the use of quotas in connection with working out trade agreements and arrangements between countries respecting imports and exports? The establishment of quotas, numerical or percentage quotas: so many dozen, or such and such a percentage of the market?

Mr. DIEBOLD. I think the case for quotas is a case for precision; that is to say, both businessmen and officials have at various times said that quotas were admirable devices, because then you knew exactly where you were, what was coming in, what was going out.

Senator BUSH. Do you think that is desirable?

Mr. DIEBOLD. I think the argument on the other side, then, is the economic argument, which is that if you are going to have barriers, a quota is a worse barrier than a tariff, precisely because it is definite. That is to say, the rigidity of the quota, which may recommend it to the administrator, certainly to the businessman who wants protection and who wants to know as closely as possible where he stands, is also one of the reasons it is economically objectionable. I think the generally accepted economic argument has been that a tariff is always preferable because, even though it puts in an obstacle, it permits flexibility above that obstacle, market conditions permitting.

It seems to me that to say that quotas are a good thing requires an assumption of a great deal of wisdom that we most of the time do not really have. I think if you have a nice, neat little problem, or if you are in the process of moving out of a protected situation, then I think quotas may have a place, suppose we were moving from one condition to another, and that we have decided that in order to make the transition easy it should be by stages, but that there is no doubt we shall really make the transition, then one could make a case for quotas that would be limited in time and that might change from year to year. Or quotas might be useful in exceptional circumstances, and everyone agrees that it is an emergency, that this is not something that you keep for the long run.

Senator BUSH. The main point is that you do not exclude the use of quotas as a proper device for regulating imports and exports.

Mr. DIEBOLD. They are there. I cannot exclude them.

Senator BUSH. I know you cannot exclude them. But you do not think we should?

Mr. DIEBOLD. I think the distinction betwen quotas and tariffs that has been made in most international agreements, such as GATT, and that was part of the general policy that the United States adopted at the end of the war, that we aimed to remove quotas and to reduce tariffs, created a desirable distinction. By and large quotas should not be used. I would admit their use as being an acceptable arrangement in exceptional circumstances. I do not think that they are desirable for the purposes that most of the people who advocate quotas want them to be used.

I agree they are effective, and that is one of the reasons I think they are an example of the choice of rigidity instead of flexibility that I was talking about before. So I would say they have a limited place and, in general one should try to get rid of them.

The CHAIRMAN. Congressman Coffin?

Representative COFFIN. Thank you, Mr. Chairman.

Mr. Diebold, I too have been interested in this catalog. I think I share our common frustration that at the moment all we can do is define the problems. Mr. Bolling raised the question, how do we pursue the consideration of these in the context of all the others?

I would like to make a comment there that one of the most valuable parts of your statement from my point of view is your discussion of economic development aid abroad, where you make the point which I have not seen made before in as articulate a way, that it is a pragmatic kind of approach. There is no such thing as the proper approach to economic development. It depends on the local problem. And this is a very helpful observation.

One specific question: You did not mention in your discussion of the common market the new Nordic Market. Would you make some observation about that and its implications for us?

Mr. DIEBOLD. Yes, sir. I think the situation at the moment is that the proposals for a Nordic Common Market are necessarily in suspense pending the solution of the problem of the free trade area. The recent origins of the Nordic Common Market predate the development of the Common Market of the Six, the European Economic Community. They were an attempt partly to solve some local problems, partly to push liberalization farther than it was going in the OEEC, which was the forum up to that time. Once negotiation of the Common Market of the Six got underway, the Nordic activity was speeded up, and what I think was generally accepted as a workable arrangement had been worked out, accepted quite widely, but not given its final political acceptance. There were fairly important compromises with regard to Norwegian industries on the one hand and a Danish agriculture on the other.

Representative COFFIN. Did this idea of the Nordic Common Market antedate the Treaty of Rome?

Mr. DIEBOLD. Oh, yes. There were serious discussions, and they had in fact formed a common parliamentary group that was discussing all of these things and had taken steps on such matters as social security, other labor arrangements, and a whole variety of nontrade things before this. It took them a long time to iron out their trade problems.

Then, just about as they came to the point where they had a workable system, the problem of the free trade area came up, and immediately there was a sort of a doubledecker problem, because the Scandinavian countries other than Finland were to be an important part of the free trade area with Britain, Austria, and Switzerland. It was pretty hard to carry out negotiations at two levels or to have a small Nordic Common Market within the free trade area, and therefore it was put on the shelf for the time being while they worked out plans for a free trade area.

Representative COFFIN. But now plans for free trade are at loggerheads, are they not?

Mr. DIEBOLD. That is right. And the latest stage has been that the Scandinavian countries, Britain, Switzerland, Austria, and Portugal have a proposal that will come up this summer, for a free trade area of their group which they hope will be a basis for bargaining with the Common Market countries.

This, again, as far as I can see, necessarily leaves the Nordic Market in abeyance, because it is a larger thing. One can conceive, if they get a free trade area, that the Nordic countries will wish to go somewhat further. There is one special matter, and that is that Finland certainly cannot go into the Common Market. Whether it can join a free trade area or not is unknown. It has so far been able to participate in the negotiations for a Nordic arrangement. Therefore, if only to make it possible to tighten economic ties of Finland with the other Nordic countries, there might be something to be said for this approach.

Representative COFFIN. This is probably impossible for you to answer, but you discussed in your paper a military problem, the problem of economic development in underdeveloped countries and problems of raw material stabilization and private investment. Is there any priority?

Mr. DIEBOLD. I do not think we can have a priority. I think all these problems face us. I think we have to work on all of them all of the time. At any given moment one problem may give worse trouble than the other and has to have priority, yes, but taking the kind of perspective I have tried to take here, one of some years, I know no way to do this. Naturally the basic military, or strategic-political problem, is fundamental. You cannot cut that to economic convenience; you have to make your decisions by themselves and accept the economic consequences of them rather than the reverse.

The CHAIRMAN. Mr. Diebold, we are constantly being asked to impose more severe restrictions upon the importation of Japanese textiles, plastics, and other products. I would like to ask you what effect you think the adoption of such a policy would have upon the foreign position of Japan. Would it not tend to cause Japan to seek a market in Communist China, and hence lead to a rapprochement between those two countries?

Mr. DIEBOLD. That is certainly one of the likely consequences of such measures.

We are currently carrying on at the Council of Foreign Relations a study of American-Japanese trade relations. The work on that is not complete. We hope that it will produce a book that we can publish early next year. I would hesitate to anticipate in any detail the conclusions because the man who is doing the study is writing it this summer. However, having participated in this work I am in a better position than I might otherwise be to note one or two of the aspects of the problem.

If you make a survey of Japans' export markets and their possibilities for expansion, the American market continues to look as if it were one of the very most important for longrun growth of Japanese exports.

This year Japan is in rather good shape, compared to bad shape last year. But so far as I can see, this is primarily the result of import restrictions.

The CHAIRMAN. If imports were shut off or greatly restricted, where would Japan turn?

Mr. DIEBOLD. She can try the possibilities of southeast Asia, of Latin America, and of Europe. In Europe she encounters precisely the same kind of difficulties as she encounters here. In Latin America and southeast Asia she has, first of all, smaller markets, because of lower income; secondly, in many fields she encounters the development of local industries, which also tend to be protected. Therefore, the Communist Chinese market remains attractive to many Japanese.

At the moment there seems to be less interest in this in Japan than there was a year ago when the trade problems were worse. I think this supports your point that it is partly a function of the general condition of Japanese foreign trade. However, this year's improvement in the Japanese balance of payments seems to rest on import restrictions rather than a great improvement in exports, and therefore the longrun trade problem may only be masked.

The one other out that Japan has—and this is something that she will have to do in the long run anyhow—is to continue the line of development that has already started in Japanese industry and exports, and that is the increased emphasis not on the traditional exports of textiles, pottery, paper goods, et cetera, but on highly processed manufactured goods, often components—the transistor story—and with high quality as in the case of optical goods, and so on.

The CHAIRMAN. If Japan feels forced to turn to China as an outlet for its manufactured goods, will not China require in return that

Japan cut or reduce its political ties with the United States and the Western Alliance?

Mr. DIEBOLD. This would seem likely, because I think that if Japan were going to China because of Japan's difficulties, the Chinese could not fail to take advantage of the bargaining position they would be in, and from their point of view the political gains are important, I would assume.

The CHAIRMAN. This would be a great weakening of the free world in its relationships with the Soviet bloc, would it not?

Mr. DIEBOLD. I think so; yes.

The CHAIRMAN. Congressman Coffin?

Representative COFFIN. I take it by your last comment that it depends on whether Japan is in a position of bargaining from strength or from weakness?

Mr. DIEBOLD. I agree.

Representative COFFIN. If it is forced to trade with China as being the only way out.

Mr. DIEBOLD. The economic question of Japanese-Chinese trade is something else, which involves more careful study than I have given it. But there is an example in what happened a year or so ago, when there was to be some expansion of Japanese-Chinese trade, and then the Chinese did make political difficulties, but the Japanese were then in a position to break off the negotiations (or let the Chinese break them) and say, "All right, we are not having any of it." As long as Japan is in that kind of position one can consider what the trade should be on a very different basis from that of the conditions suggested by the chairman.

The CHAIRMAN. Senator Bush?

Senator BUSH. I have no questions.

The CHAIRMAN. You have spoken of the recent adoption by Russia, and to some degree by China, of foreign aid. I would like to ask just how serious you think this is, what forms it takes, and whether you think it requires any change in American policy?

Mr. DIEBOLD. I think it is serious. I think it requires a change in American policy to the extent of knowing that something new is going on that was not there before, up to 5 years ago, and that, insofar as I can see, is likely to go on for the indefinite future.

If we assume that there is no war, it is fairly clear that one of the ways in which the U.S.S.R., and China too, can hope to spread their influence in the underdeveloped countries, which are very important to them, is through the development of an aid and trade program.

The CHAIRMAN. Do I understand that this thus far has taken the form exclusively of loans?

Mr. DIEBOLD. Predominantly of loans, I think not exclusively. I think there are certain grants, but that grants are very small compared to loans; that the loans are sometimes in the form of providing a credit over a period of years which covers the construction of, say, the Indian steel mill, in which the actual construction is carried out by the Soviet Union. There are a number of such cases, not always carried out by the Soviet Union, but often by the East European satellites. The Czechoslovakians and the East Germans play a great part in this. Sometimes the Soviet loans are simply to cover the delivery of industrial goods of one sort or another. Then, of course, another fairly important element has been one that looks like trade but is in effect a kind of aid, and that is the purchase—or barter, really—of raw materials surpluses, the payment for which is then made over a period of years. This, of course, is really a credit from the underdeveloped countries to the Soviet Union, but in terms of relieving economic pressures it looks like aid to some of them.

As to the size of this program, I do not have the figures in my head. Last year the Council on Foreign Relations published a book that studied the first several years of this program, a study by Joseph Berliner, called "Soviet Economic Aid." Berliner estimated the actual use of this aid spread out over a period of years. That is to say, the Indian steel mill is going to take, as I recall, 5 or 6 years to build, but the total Soviet aid was announced as a sum in 1955. If one estimates how much aid was probably used per year and gives the figures on the same basis as our own statistics, in actual delivery, then the amounts of the Soviet aid program fall considerably below what many people have believed them to be.

The CHAIRMAN. What would you estimate it as being on an annual basis?

Mr. DIEBOLD. I hesitate to give a figure, but I seem to recall that by last year it was something like $300 million a year, including an estimate for military aid, which is again a difficult one to value.

The CHAIRMAN. Perhaps a third of the amount, then, that we give.

Mr. DIEBOLD. I would really be happier if I would look that figure up and send it in to you.

Representative COFFIN. Yes.

(Mr. Diebold subsequently submitted the following statement:)

Berliner estimated that the utilization of total Soviet bloc credits in 1957 was between $160 million and $200 million. This did not include military aid. It could be presumed that the figure for 1958 would probably be somewhat higher since substantial amounts of credit remained unutilized ("Soviet Economic Aid," p. 42).

The Department of State estimated that by the end of 1958 total utilization of Soviet aid came to a little under a billion dollars, including military aid. A roughly comparable estimate by the State Department for the period up to February 1, 1958, suggested utilization of a little under $700 million up to that time. This would yield a figure for 1958 of something on the order of $300 million, including both economic and military aid ("The Sino-Soviet Economic Offensive in the Less Developed Countries," Department of State Publication 6632, May 1958, pp. 21–23; "The Communist Economic Threat," Department of State Publication 6777, Mar. 1959, pp. 9–10).

Mr. DIEBOLD. What Berliner did was to take each known case of Soviet bloc aid, take the year in which the credit was given, and consider the purpose of the credit. Some of it, of course, was used right away, when goods were delivered. But if they were building something, he worked out the period of years that one could apply to this by normal standards and projected it ahead to get an estimate of actual use. There has been some increase from year to year but not a sharp increase, as I recall.

Again, one has to look at this very closely, because in making their propaganda, the Russians have a more effective system of making it sound as if they were giving aid than we always do. As I recall, for instance, they offered Indonesia several years ago a hundred million dollars. It took a year or two for the Indonesians to agree to take this. This was twice the aid that was announced, and I think it is only within the last 6 months that the first project has actually been commissioned, and this is announced again. This is advantageous from their point of view.

The CHAIRMAN. What is the average interest rate which the Soviet charges?

Mr. DIEBOLD. I think they have had a firm practice of charging 2 to 2.5 percent.

The CHAIRMAN. When we make loans, what is our interest rate?

Mr. DIEBOLD. I think we have several rates. Loans repayable in dollars and loans repayable in local currencies carry different rates. I rather think that the local currency rate runs around 4 percent.

The CHAIRMAN. And the dollar rate?

Mr. DIEBOLD. And the dollar rate is a bit lower. I think it is often 3.5 percent. Some loans are made at higher or lower rates. Export-Import Bank rates tend to be higher that ICA or DLF rates. World Bank rates now I guess are lower than 5 percent.

It is perfectly clear that the Soviets have gained considerable advantage in terms of the receptivity of their program by this 2.5 percent rate, and there has been a good bit of speculation as to how they arrived at it. There are some people who find it geared to their domestic practices, others who think it was just a rate that was picked to make it embarrassing for us, since they stressed the fact that they give loans and not grants, on the ground that this is more businesslike.

The CHAIRMAN. In other words, they are 1 to 1.5 percent below the American rate and 2 percent below the World Bank rate?

Mr. DIEBOLD. Something like that.

The CHAIRMAN. And what is the International Monetary Fund rate?

Mr. DIEBOLD. I do not know.

The CHAIRMAN. Congressman Coffin?

Representative COFFIN. There are some people who say, I think probably most people in Congress feel, that the loan idea as it started in the Development Loan Fund, is a good new approach. There are others who say that because of the accumulation of local currencies that this produces in the countries, it is not a good thing and there should be outright grants. Others say there should be a complete overhaul of the whole foreign aid program—overhaul to what we are not often told; or if we are, it is phrased in a monolithic type of assistance.

Based upon this colloquy between you and Senator Douglas on the Russian system, which is more narrow than ours, and which covers a wide variety of aid, do you have any observations as to where we should put our emphasis?

Mr. DIEBOLD. I have been concerned with this problem. I am trying now to come to some clear conclusions about the problems which the Soviet program poses for us and to what extent we should adjust our policies to meet this competition.

I have tentatively come to the conclusion that there are not many cases in which we ought to be deciding what our policy should be because of the fact that the Russians are doing thus and so. I think that we are interested in larger gains. They are late comers to the field of aid and trade. They are going to make certain political gains from the fact that they can take advantage of things we are doing, either mistakes or friction incidental to perfectly sound measures. I think there are a number of cases in which we can usefully change some of our practices in ways that will reduce this impact. I do not think this should be our primary concern. I think we have first to look at what it is that we are doing in giving aid, then we can tell how much attention we should give to adjusting our policies because of what the Russians do. Economic development can be carried on in a variety of ways. I think that our greatest single defense against the spread of Soviet power via a trade-and-aid program is by reducing the vulnerability, of all sorts, of the free world. The better we make the free-world economy function, not the less aid and trade there will be from the Soviet Union, but the more easily it can be absorbed in constructive fashion. After all, the Indians are getting the steel mill. This is not fake, the Soviet aid and trade.

As to the specific problems of local currency, interest, grants versus loans, and so on, I think we are heading for some very serious problems on the accumulation of local currencies. They are useful up to the steel mill. This is not fake, this Soviet aid and trade.
a point. That is, they are a way of helping local government, a receiving government, mobilize its local capital up to a point. It makes a great difference how the local currency is created, of course, whether it is simply put down in the books or whether it in fact represents something real or not.

The CHAIRMAN. Congressman, may I follow up on that point?

Representative COFFIN. Certainly.

The CHAIRMAN. On this very point, Senator Long, of Louisiana, made a very important speech on the floor of the Senate some weeks ago which was not noticed in the press, and really has been unobserved. He charged that the Greek experience, in which a hundred million dollars of locally accumulated currencies were used, not for domestic improvement but to pay off a portion of the Greek public debt, was not an isolated affair, and that in fact $2.5 billion of locally accumulated currencies had been used by the State Department or the CIA to pay off the local debt—national debt.

I approached him subsequently and asked him if he were sure of his facts, and he said he was. He is a member of the Foreign Relations Committee, and therefore presumably has access to classified information which is not normally available. These facts tend to be sealed off, you know, from Congress, but we frequently find that people in New York have better access to them than the Members of Congress.

I wondered if this statement of Senator Long seemed to you to be correct.

Mr. DIEBOLD. I do not know. If the figure is—did you say $2.5 billion?

The CHAIRMAN. Yes.

Mr. DIEBOLD. Then it must include the Marshall plan counterpart funds.

The CHAIRMAN. Yes.

Mr. DIEBOLD. Which are a somewhat different matter, after all.

The CHAIRMAN. Yes; it does include the counterpart funds as well as the funds accumulated under Public Law 480.

Mr. DIEBOLD. I do not know about this question, Mr. Chairman. I know that during Marshall plan days this was a great issue in Western Europe. And as I recall, a stipulation was made after several years that the counterpart funds were not to be used to reduce public debt, although there was a very good argument that if they were to be used generally for anti-inflationary purposes there were times and places when this would be a helpful thing to do.

The CHAIRMAN. If used to reduce the public debt, what they primarily would do would be to help the individuals who owned the public debt, is that not true, and make their holdings more secure than would otherwise be the case?

Mr. DIEBOLD. It would of course depend on the character of the debt structure of the particular country.

The CHAIRMAN. Is it not true, nearly always, that the public debt tends to be held by the group which has a surplus income, and therefore, tends to be held by the wealthy group withing a community, the predominance of the debt?

Mr. DIEBOLD. I think, sir, that a lot of the public debt in postwar Europe was owed to the Central Bank. It was part of the inflationary problem.

The CHAIRMAN. If it reduced the privately held debt.

Mr. DIEBOLD. If it reduced the privately held debt you would have a different result. It was my impression that this was not done under the Marshall plan.

The CHAIRMAN. You do not know whether Senator Long's statement that $2.5 billion have been so used is correct, do you?

Mr. DIEBOLD. I would have to look that up.

The CHAIRMAN. I think this is a highly important point, because it bears upon the whole question of local currency. I personally hoped that these local currencies would be used to carry out constructive domestic work, and in the countries where there is idle labor it seems to me that the use of these funds for these purposes would not cause inflation but would put idle labor to work with materials that would otherwise not be utilized, and hence would build up real national income and also the capacity for future growth.

If it be true that these counterpart funds have been used instead primarily to reduce the privately held public debt, it seems to me it was a grave mistake, and one which deserves the closest scrutiny.

Representative COFFIN. May I interject?

The CHAIRMAN. Yes, indeed.

Representative COFFIN. The target has been made, and I would like to have you give some attention to it in your answer to Senator Douglas, that there are times when—and I have no expertese in this problem—but the argument has been made that the most helpful way of using local currencies in some countries at some times, and the most noninflationary way to use them, is to pay off the national debt or part of it.

The CHAIRMAN. I would like to say to my good friend and colleague this is an argument which is very popular amongst those people who hold the public debt in these countries.

Mr. DIEBOLD. I can only say that the use now of the new local currencies is a different matter. They are in a different legal position from the Marshall plan counterpart money . The United States made grants to Western Europe. The European Government was required under the aid agreement to put up the counterpart in a fund, the use of which was determined by the United States and the local government together.

The Public Law 480 funds and other kinds of local currency are in fact owned by the U.S. Government. They are payment received for goods delivered which are called sales and which are not grants of the sort that were made in Western Europe. There are certain arrangements between the U.S. Government and the local gvernments as to how these should be used.

I am not privy to these arrangements. I know only what I see in the statistics on their use, and it appears to me, first of all, a very large part of them remains for a long period unused, because they are apt to be accumulated at considerable rates, and also not with any relation to development needs. That is, in many cases the Public Law 480 sale has no relation to possible uses of local currency.

The CHAIRMAN. I do not wish to be sardonic but I would like to request that probably since this information is more available to organizations in New York than to Members of the U.S. Congress, you might apply your best efforts to find out what has actually happened to these counterpart funds, and whether in fact they have been used in these quantities to reduce the internal debt of these countries.

(The following was subsequently received for the record:)

COUNCIL ON FOREIGN RELATIONS, INC.,
*New York, N.Y., July 7, 1959.*

Senator PAUL DOUGLAS,
*Senate Office Building,*
*Washington, D.C.*

DEAR SENATOR DOUGLAS: When I appeared before the Joint Economic Committee on the morning of June 29, you asked me some questions about the use of counterpart funds to repay national debt and suggested that I might wish to file a supplementary statement after looking further into the matter. In particular, you referred to a recent statement by Senator Long which I had not seen. I have now looked into these matters and feel that I do not have enough to add to what I said on the 29th to warrant submitting a formal statement or memorandum. I hope this letter will seem sufficient to you.

The main facts about the use of Marshall plan counterpart funds to retire debt in Europe are set out in a State Department memorandum prompted by Senator Long's statement and inserted in the Congressional Record by Senator Fulbright (June 9, 1959, pp. 9293–9296). My testimony was faulty in that I mentioned the ban put on the use of counterpart for debt retirement just as the Marshall plan was ending but did not stress, because I had forgotten, that this practice had accounted for an important part of the use made of counterpart funds before that time. Since then debt retirement from counterpart funds has been limited to certain special cases covered by legislation. ICA reports show that in fiscal year 1958 about $112 million was used this way in Austria and $114.5 million in Greece. These appear to be the only cases since fiscal 1956, to which the figures in the State Department memorandum cited above run. I find no record of the use of counterpart to retire debt in other parts of the world. The question does not come up with regard to local currencies owned by the U.S. Government as a result of Public Law 480 sales and similar transactions. These are to a considerable extent lent to the local governments and so create debt.

So far as the wisdom of using counterpart funds to cancel debt is concerned, it seems to me that one can hardly generalize. Without the chance of making a careful study of the whole experience, I think I should stick to what I said in my testimony, that the matter depends on the character of the debt and on the economic and fiscal condition of each country at the time. It is easy to see that there can be cases where some kind of sterilization of the counterpart funds (or, for that matter, U.S.-owned local currency) would contribute to checking inflation. Whether the next step, their obliteration, would be desirable seems to depend on circumstances. It looks to me as if the debt retired by the use of counterpart was often the equivalent of the debt created in setting up the counterpart funds. The debts repaid out of counterpart in postwar Europe seem to have been principally debts to the central bank, and perhaps in some countries other debts resulting from Nazi-dictated financial practices of the time these countries were occupied. Perhaps the same results could have been achieved by other means. To determine whether it was useful to retire this debt out of counterpart seems to me to require an investigation that would carry one quite far into national fiscal practices and into an appraisal of the situation in each country at the time. For that reason I cannot now add significantly to what I have already said.

So far as the proposed cancellation of debt in Greece is concerned, which gave rise to the recent controversy, I can pass no useful judgment since I know too little of the circumstances. The issues seem clearly drawn in the statements by Mr. Dillon and Mr. Long.

Sincerely yours,

WILLIAM DIEBOLD, Jr.,
*Director of Economic Studies.*

(Dictated by Mr. Diebold, but signed in his absence.)

(Material referred to in above letter of William Diebold, Jr., to Senator Paul Douglas, chairman, Joint Economic Committee:)

[From the Congressional Record, June 9, 1959]

Hon. J. W. FULBRIGHT,
*Chairman, Committee on Foreign Relations,*
*U.S. Senate.*

DEAR MR. CHAIRMAN: During the hearings before the Foreign Relations Committee on May 4 Senator Long requested additional information explaining the situation in Greece which has led the executive branch to propose that section 516 of the Mutual Security Act be amended to permit the use of counterpart for debt retirement when any other use would adversely affect economic and financial stabilization. The purpose of this letter is to supply the additional background information requested.

When the United States provides commodities to a foreign country as grant aid, that country is required to deposit into a special account an amount of its own currency equivalent in value to the commodities furnished. As the committee is aware, these local currency deposits are called counterpart funds.

Counterpart funds, with the exception of a small amount set aside for U.S. uses, are the property of the foreign government concerned. Nevertheless, by agreement between the United States and the other government, they may be used only to further the purposes of the mutual security program, and their use for specific expenditures must be agreed upon by both governments.

A counterpart account was established in Greece at the beginning of the Marshall plan and has continued to exist until the present time. The use of the counterpart account has been the subject of continuous discussion between the two governments as contemplated by the legislation.

To put the matter into perspective, it is useful to recall the policy covering the use of counterpart funds in the days of the Marshall plan when aid to Greece was very substantial. The question of counterpart uses was considered at some length by the Congress, and in particular by the Senate Foreign Relations Committee, during that period. In its Report No. 935 (80th Cong., 2d sess.) the committee recorded its view that appropriate uses of these funds would include:

"(a) Immobilization of the local currency, in whole or in part, to assist in measures of financial reform and currency stabilization;

"(b) Use for retiring the national debt so as to promote the most rapid achievement of financial stability."

The Greek Government was at that time confronted with the extremely difficult problem of reconstructing and restoring a country and an economy ravaged by invasion and civil strife. It was compelled to make very heavy expenditures of Greek currency, which in turn led to serious inflation. The effort of the United States throughout this period was directed toward support of Greek efforts to restore sound economic and financial conditions. In this connection, the ability of the U.S. Government representatives to control the expenditure of counterpart funds, thereby immobilizing or sterilizing large amounts, was one of the most useful devices to preclude more serious inflationary pressure. Thus, sterilization of a considerable portion of the counterpart funds was an important factor in restoring economic stability.

It had been originally contemplated that these sterilized counterpart funds might ultimately be used to retire some of the very substantial debt incurred by the Greek Government to its Central Bank. Action to this effect was deliberately postponed pending further improvement in the Greek fiscal situation.

However, in 1953 Congress enacted legislation which prohibited the use of counterpart funds for debt retirement. This prohibition (now sec. 516 of the Mutual Security Act) of course did not mean, nor was it intended to mean, that counterpart funds should be spent for uses which would be contrary to the objectives for which aid had been provided. In other words, there remained a responsibility to see to it that counterpart funds would be used to promote economic and fiscal stability.

In recognition of the fact that release into the Greek economy of a large amount of counterpart funds would be unwise the executive branch proposed and Congress enacted a proviso to section 516 which enabled us to reach an agreement in 1957 with the Government of Greece to cancel about $115 million of Greek Government debts to the Bank of Greece. This authority was limited, however, to very special circumstances, and is not applicable to the remaining counterpart funds now under discussion. We are now talking about 3.6 billion drachma, equivalent to $120 million, which still remain on the books unreleased. This represents about 18 percent of the total of more than 20 billion drachma generated during the history of the program.

To inject this additional amount of local currency into the money supply of the Greek economy would, in the opinion of both Governments, have serious inflationary consequences. It would simply increase the amount of money available without increasing in any way the amount of goods or services available for purchase. The obvious effect would, of course, be to increase prices and costs for all concerned. Rather than benefiting the individual Greek citizen it would have directly opposite results since inflation hits first and hardest at the low-income groups.

The Greek Government itself has been faced with considerable internal pressure to spend these funds but in view of the obvious inflationary consequences, the Government has courageously withstood these pressures and made plain its intent to maintain this account as a sterilized one.

This is the situation in which we are asking for the amendment. If the amendment is not adopted we anticipate that, since both Governments are agreed that expenditure of the counterpart funds would be inflationary, the counterpart funds would continue to be sterilized. Such sterilization could continue for several years to come. However, if the amendment is adopted, we expect that the major portion of the funds will be used to cancel an equivalent amount of the debt which is carried on the books of the Greek Central Bank. This is not debt which is owed to individuals, nor does it constitute a burden on the Greek Government which must be retired at some future date from current revenue. The proposed use is, of course, neither inflationary nor deflationary since it merely amounts to a cancellation of a nominal government asset and an equivalent nominal government liability.

It may be added that our economic programs in Greece have been directed toward promoting development within the framework of a sound economic and financial policy. These efforts have been eminently successful, as may be seen by reference to the presentation materials submitted to the Congress. For example, between 1952 and 1958, real gross national product increased by nearly 50 percent, consumption rose by 40 percent, and private investment increased by 50 percent. These results, we believe, fully justify our adherence to sound economic and fiscal policy as the basis for economic development which has been truly beneficial to all the citizens of Greece.

As you know, the new director of the International Cooperation Administration is Mr. James W. Riddleberger who, as a result of his assignment as American Ambassador in Greece, is thoroughly familiar with this situation. As soon as he assumes his new duties, I will ask him as a matter of first priority to review carefully this matter. In any event, no action will be taken prior to the completion of this further review.

Sincerely yours,

——— ———, *Acting Secretary.*

MEMORANDUM

This memorandum is in response to Senator Fulbright's request for examples of cases where, in the past, counterpart funds have been used for debt retirement or other financial transactions similar to that which will be undertaken in Greece, if section 516 of the Mutual Security Act is amended as requested.

The clearest examples of the use of counterpart funds for debt retirement occurred in the countries of Western Europe during the Marshall plan period from 1948 to 1952. As Mr. Dillon pointed out in his letter of May 14, 1958, it was a basic policy of the Marshall plan program, understood and approved by the Congress, that counterpart funds derived from Marshall plan aid would be released only if the use proposed for such funds would not have a dangerously inflationary effect, and that counterpart funds might be used to offset Government deficit financing or other internal inflationary pressures. In some circumstances, it was recognized that the most effective way of accomplishing this latter objective would be through debt retirement.

The importance attached to the avoidance of inflation and recognition of the danger that injudicious releases of counterpart might compound an inflationary situation were reflected in the requirement on ICA to consult the National Advisory Council on International Monetary and Financial Problems before agreeing to any releases of counterpart. Every program for the release of counterpart had to be considered with this body, which is chaired by the Secretary of the Treasury, and which, under the law, still exercises these advisory functions.

Throughout the Marshall plan period, when the reconstruction of Western Europe was the primary objective of our economic assistance program and when the establishment or maintenance of monetary and economic stability was recognized to be essential to reconstruction, the effect of National Advisory Council review was frequently to suspend, limit, or withhold the release of counterpart in situations where its release would have increased the demand for the available resources of goods and services and thus have been dangerously inflationary.

As the reconstruction of Europe was completed, the emphasis in economic assistance programs shifted to other parts of the world, where the financial and administrative organization of government and private enterprise was in many instances less well developed and less experienced than in Europe. There were more instances where countries were confronted with problems of a development or defense nature for the first time in their independent history. The common assumption grew that, wherever possible, all counterpart funds would be allocated as rapidly as generated to finance development projects and to provide support to budgets, both civil and military. This pattern was accentuated as we began to deal with a number of countries in which the primary need of aid is to finance local currency expenditures rather than to provide foreign exchange to maintain essential imports. Since the passage of legislation in August 1953 prohibiting the use of counterpart funds for debt retirement, the effort to establish financial stabilization by withholding the use of the counterpart of aid, or sterilization, as a direct offset to inflationary pressures has become less and less common.

We have provided this brief review of the background of the problem of debt retirement in order to explain the importance accorded to financial objectives in the Marshall plan period and to account for the fact that the examples which are discussed in the enclosed statement are all from Western Europe and from the period before fiscal year 1953.

The use of counterpart funds to retire a Greek Government debt to the National Bank of Greece is the only transaction now under consideration for which the new legislative authority we have requested is necessary. Because of the form the economic aid program has taken in the past several years, few such cases are likely in the future. Nevertheless, circumstances do arise from time to time in which U.S. objectives are best served by withholding the expenditure of counterpart funds, and thus (to put the matter in purely monetary terms) using grant aid to offset inflationary pressures which already exist, as distinct from those which might derive from the expenditure of counterpart. In such cases, as in the Creek case now under consideration, the wisest use of counterpart funds may be to retire a government debt. This is another instrument, in addition to those with which existing legislation arms the administration, for achieving the basic purposes for which foreign aid is given.

## THE INTERNATIONAL COOPERATION ADMINISTRATION—THE USE OF LOCAL CURRENCY COUNTERPART FOR DEBT RETIREMENT, 1948–52

The economic cooperation agreements with countries participating in the Marshall plan, originally signed in 1948, and as amended later, generally included expressions of intent by the participating governments to exert their best efforts for certain economic and financial objectives, among them to create or maintain a stabilized currency, internal financial stability, and confidence in their monetary systems. The listing of purposes for which the special counterpart account might be drawn upon specifically included the effective retirement of the national debt, especially debt held by the central bank of other banking institutions.

The agreements in Europe required the deposit in a special counterpart account of local currency commensurate in value with all the grant aid received. No distinction was drawn as to whether there were actually sales proceeds generated directly by the aid, as was provided under the Mutual Security Act of 1954.

In the course of the first 4 years of operation of the aid program after the passage of the Economic Cooperation Act of 1948, approvals to release local currency counterpart for debt retirement amounted to the equivalent of $2,510.8 million plus an additional $72.5 million of Austrian local currencies arising under prior legislation for which the Economic Cooperation Administration had assumed responsibility. A summary of the cumulative total of these actions by country appears below. All the basic considerations of issues and approval of the action proposed took place before the end of fiscal year 1952, and for the most part before the end of fiscal year 1951. The table, however, is arranged to show the time when the withdrawal from the special accounts took place:

INTERNATIONAL COOPERATION ADMINISTRATION

*Counterpart funds withdrawn for debt retirement by fiscal year*

[Millions of dollar equivalents]

| Country | Cumulative June 30, 1956 | Fiscal year | | | | |
|---|---|---|---|---|---|---|
| | | 1949 | 1950 | 1951 | 1952 | 1953 |
| Total | 2,583.3 | 798.8 | 315.2 | 1,075.3 | 260.4 | [1] 133.6 |
| Austria, total | 85.0 | 85.0 | | | | |
| Public Law 472 | 12.5 | 12.5 | | | | |
| Public Laws 84 and 389 | 72.5 | 72.5 | | | | |
| Denmark | 130.1 | | | 88.3 | | [1] 41.8 |
| France | 171.4 | 97.4 | 74.0 | | | |
| Netherlands | 197.4 | | | | 197.4 | |
| Norway | 292.7 | 42.3 | 31.2 | 127.4 | | [1] 91.8 |
| United Kingdom | 1,706.7 | 574.1 | 210.0 | 859.6 | 63.0 | |

[1] Withdrawn in July 1952, but approved for withdrawal in fiscal year 1952.

NOTE.—Dollar equivalents have been figured at the exchange rates in effect when the withdrawals were made. ICA data covers actions of predecessor agencies.

### UNITED KINGDOM

Two-thirds of the debt retirement releases of local currency counterpart for debt retirement were approved for the United Kingdom where such withdrawals totaled 529 million pounds sterling. The physical destruction wrought in the United Kingdom by the Second World War was accompanied by the deterioration of its international financial position which had shifted from net assets to major liabilities, making the United Kingdom a large-scale debtor. During this period the United Kingdom was making a strong effort to rebuild the wartime destruction of the country and to increase productivity and output. There was the strongest interest in building up export earnings to offset the deterioration of the international financial position and to reduce the need for aid. The domestic economy was beset by inflationary pressures generated during the war and in the early postwar period.

As an aspect of the reconstruction efforts, positive measures were taken to try to prevent the generation of further inflationary pressures and strenuous efforts were made to plan for and to achieve a surplus in the central government budget. The advance assessments of what could be undertaken and what the budget could afford were drafted in terms of the resources expected to be available as a result of domestic production and from the assistance provided. Efforts were made to limit domestic consumption and to hold domestic capital expenditure to the level that could be supported by the physical resources available, bearing in mind the competing urgent necessity to increase exports. In the effort to reinforce the confinement of private and public undertakings to the level which the resources effectively available would allow, the United Kingdom had begun to follow a practice of using the local currency receipts developed as a result of foreign aid to retire public debt even prior to the commencement of the European recovery program and the assistance rendered under the Economic Cooperation Act. In consideration of maintaining as close a balance of available resources with desirable uses as possible, the initial decision, first taken in the summer of 1948, to continue this practice of debt retirement and to apply withdrawals from the special local currency counterpart account to the repayment of United Kingdom treasury debt held by the Bank of England was reaffirmed in each of the following 3 years but always after a fresh review of the prevailing situation.

### NORWAY

During the wartime occupation of Norway by German forces the Government of Norway was obliged to provide funds to Germany to pay the cost of the occupation of their country. The reflection of this action took the form of a debt by the Government of Norway to the Central Bank of Norway. At the beginning of the European recovery program the Government of Norway was faced by latent inflationary pressures which it was making strong efforts to control through budgetary and administrative measures and through blocking accounts in order to prevent their use from increasing the level of demand within the country. A policy of gradually wiping out the overhang of the old occupation accounts was begun and followed, with periodic reconsideration and reaffirmation of the suitability of this action, for most the period 1948–52. The Governmen of Norway was also using its own blocked funds and certain tax resources for this purpose.

In 1950, for example, the review of the financial and economic situation noted that the Government of Norway was contemplating a cut in the investment program to limit its inflationary impact and an anticipated budget deficit. There was also great concern to prevent a deterioration in the balance of payments and to facilitate Norwegian participation in the OEEC trade liberalization program, which an increase in inflationary pressure would hinder. The greater part of the counterpart funds were thus used for retirement of the occupation account as a deliberate factor in controlling the expansion of the money supply and the pressure of inflationary demands upon the limited existing resources. The first action to include also some direct support for investment and defense in the counterpart program was taken only late in 1951 when the degree of stabilization maintained and the existing priorities appeared on balance to justify the action.

### DENMARK

The first significant program for the use of counterpart was presented by the Government of Denmark in 1950. Prior to that time the funds had been sterilized in the special counterpart account. During the period of the wartime occupation, the payment of German occupation costs was reflected by an increasing debt of the Government of Denmark to the Danish National Bank. After 1948 there was considerable concern in Denmark lest the release of the counterparts funds for investment would generate increased inflationary dangers which Denmark could not withstand. The Government had been taking strenuous measures to control inflation from 1946 on through such measures as creation of an effective net surplus in the budgets of the central government and local administrative units, through capital levy, through internal stabilization loans, and through sterilization of the counterpart of foreign assistance.

In the Danish consideration of policy the proponents of debt retirement had to balance the desires for investment against the concern for stability. The counterpart use proposal of 1950 involved a permanent sterilization of part of the accumulated counterpart account through its use to reduce the occupation account debt of the Government of Denmark to the Danish National Bank. It also proposed the use of a smaller amount of counterpart funds to support investment.

Similar considerations involving the calculation of the level of activity which could be supported by the physical resources available and the concern to prevent inflation were involved in a further proposal of the same kind made in the latter part of 1951. This called for assignment of half the projected release to debt retirement of the same kind as in 1950 and the balance for investment and defense uses. It was considered that to release any more funds for current use at that time would place too great a strain on the internal financial situation in Denmark. In consequence the Economic Cooperation Administration approved the release and the debt reduction was again undertaken.

NETHERLANDS

The use of counterpart by the Netherlands was keyed to the physical availability of resources and the continuing concern to limit the impact of inflationary developments and to maintain an effective internal stabilization. As a result, beginning in 1948, a considerable volume of the local currency counterpart generated by the aid program had in effect been temporarily sterilized. In 1952, as a part of its proposal for the use of counterpart made at that time, the Government of the Netherlands proposed to retire some of its debt to the Netherlands Bank, which would in effect make permanent the temporary sterilization of that portion of the counterpart account. The debt which it was proposed to eliminate had arisen when the Government of the Netherlands took over from the Netherlands Bank, in exchange for Treasury bills given to the bank, accounts accumulated by the bank during the Nazi occupation of the Netherlands during the Second World War and which had subsequently become worthless. During 1951 there had been a rapid improvement in the Netherlands, offsetting the inflationary situation which had built up following the outbreak of war in Korea. However, with the contemplated increase in defense activity and counterpart expenditures still to be completed under programs previously approved and contemplated under the release proposed, it was considered that to press a larger expansion of current activity than that already projected would be unwise and might endanger the stabilization achieved.

AUSTRIA

Determinations on the use of local currency counterpart in Austria in the fall of 1948 involved the most serious consideration of issues involved in assuring an appropriate balance of the pressure demand against existing resources of goods and services. The fear of inflationary consequences of overextension was paramount and the effectiveness of releases for investment and for industrial development were dependent upon a satisfactory fiscal and monetary program as a whole. Under these conditions, the Austrian Government planned to use a significant amount of counterpart funds under ECA control and also of local currency from other sources for reduction of the Government debt to the Austrian National Bank.

In essence the technical action which reduced the debt of the Government of Austria as reflected in the books of the Austrian National Bank made permanent the temporary sterilization of counterpart account which it had been necessary to effect in order to avoid the inflationary consequences of a further increase in the level of demand within the country. The Government of Austria was heavily dependent upon assistance to carry out its official commitments. The most careful review, step by step, of economic and financial developments was a regular part of the operations of the U.S. Economic Cooperation Mission in Austria. The Austrian Federal budget was already in deficit and anticipated increases in revenue were expected to meet only part of the increased need. It was clear that however desirable the investment programs, they would only be frustrated by the mere release of additional funds to compete with existing demands for the available goods and services. Under these conditions it was agreed that the use of local currency counterpart for debt retirement would help to support the program to control and limit inflation and prevent the undermining of the confidence of the country in its financial leadership and in the stability of the currency.

FRANCE

France faced most serious economic difficulties in 1948. In September of 1958, following a succession of governmental crises, the Prime Minister submitted to Parliament a program of economic and fiscal measures looking to increase Government revenues, to check inflationary credit, to effect economies in expenditure, to undertake investments aimed at improving the balance of payments, and seeking to expand exports. The basic question at issue underlying this concern was the commitment to the total level of activity involved in the actions of the Government and private enterprise compared with the availability of resources from domestic production and from the imports financed through assistance.

Under the circumstances which prevailed at the time, the contemplation of the counterpart program had to take into account more than merely the direct uses which could be supported. In consequence the decisions as to the degree to which investment could be supported had to be balanced by the restraint which would be effected by allowing part of the release to be used for debt retirement to counteract the inflationary pressures which would otherwise result from the Government's reliance on central bank financing. As a consequence, in both fiscal year 1949 and fiscal year 1950, approvals for release of counterpart for debt retirement were given and approval of releases for investment expenditure were limited to a degree consistent with the objectives of maintaining or restoring a degree of financial stability in France.

During this time the economic situation was moving quite rapdly and it was necessary to follow the situation in close detail over the intermediate term as well as for longer periods of foresight in the attempt to maintain a balance of inflationary and deflationary forces. The retirement of the public debt, as an offset to inflationary financing already in prospect, would neutralize the inflationary advances to the French Government and would result in the permanent sterilization of the counterpart. Debt retirement was, therefore, the closest reflection of the real situation and he inabiliy to impose any additional requirements for expansion which would be beyond the resources available.

The CHAIRMAN. Does that meet with your approval?

Senator SPARKMAN. Mr. Chairman, I think it is fine to ask this witness to dig into this, because it is something that we are far removed from here. But it occurs to me that we might very well have Mr. Dillon, or someone who actually does the spadework on this, come up and give us the story.

The CHAIRMAN. We were told it was classified information which the Department of State refused to give to Congress.

Senator SPARKMAN. We had a statement given to us in the Foreign Relations Committee, and I thought it was made public. I am not certain.

We might also inquire of the Foreign Relations Committee's staff as to whether or not that information did have a classified status.

I think it is an interesting problem, and it is one that I certainly would not try to pass judgment on, because I am not a fiscal expert. I do note that the whole question of the counterpart parts and of local currencies—perhaps one of the local currencies, primarily, has become quite a problem for our Government. I think it is more in the case of local currencies that have accumulated under Public Law 480 sales and other transactions of a similar type, that it has become a problem, because loans are made to us in local currencies, and they actually go into the Treasury of the United States.

But in the case of counterpart funds, they stay there and, except for 10 percent, I believe it is, that we are able to use for meeting our own expenses in those countries, they stay there subject to joint control of the two countries, and ordinarily are supposed to be used for projects that will improve the economy of the local country.

The CHAIRMAN. That is what I had always thought.

Senator SPARKMAN. So it is a two-headed problem.

I think it would be interesting, even if some of the evidence may be classified, to have someone testify to give us as much information as possible on the record, and perhaps in executive session we might find out even more.

The CHAIRMAN. I wonder if you would be willing to submit a supplementary statement on this point which might aid the Congress in this matter.

Mr. DIEBOLD. Sir, I do not in fact think I am in a position to find out anything you are not. I shall be perfectly happy, if you wish, to submit a brief statement to you.

I have looked into what the statistics show, but not into details country by country. The Department of Commerce regularly publishes figures which show the rate of accumulation of the local currency funds and their use. Some of the use is for American expenses abroad, and an important use is the relending, as Senator Sparkman has indicated, of some of these funds to the local government for development projects. They can be used to finance the local currency cost of some projects financed froam abroad, and now it is possible to link some of those with Export-Import Bank loans. One of the uses that the International Development Authority that is being discussed would make of these is to supplement the hard currency with aid that comes from outside.

I did not see the statement of Senator Long that you referred to. I had not heard an allegation about paying off the public debt with local currency funds. I think there is a special problem of the counterpart funds, and of local currency funds of all sorts, in those countries where American aid in the form of agricultural products or other civilian goods is being used, as it is in Spain, to provide the financing for local base building or, as in Vietnam or other places, for troop pay or things of that sort. Here, I think, one might well encounter not only classified information, but degrees of complexity in the process that I, certainly, sitting on the outside, would have no hope of fathoming without going and looking over somebody's shoulder, which I am not in a position to do.

Representative COFFIN. I just want to come back to the end that is left dangling. My question, as a matter of cold economics, is whether there would be times when reducing the national debt of another country through the use of local currency or counterpart would be a sensible thing to do.

Mr. DIEBOLD. Yes, sir. It depends, it seems to me, entirely on the debt structure of the country.

Representative COFFIN. Who holds it?

Mr. DIEBOLD. Well, if, for instance, there is debt which is bank lending, which serves as the basis for further credit, and if there is an inflationary situation, then the use of the local currency to reduce the Government's debt to the Central Bank, if that wipes out an account which multiplies through the credit system, will be deflationary and will be useful. To what extent such a situation exists or can be dealt with in that way in any given country, I am in no position to say.

Representative COFFIN. Are you familiar with the Straus report, the three-man report?

Mr. DIEBOLD. I have read it. I am familiar with it in that I have studied some of its recommendations, but not in the sense of being able to recite on the whole thing.

Senator SPARKMAN. I could speculate on different situations that, as far as I know, do not exist, but suppose that we accumulated a surplus holding of local funds of some particular country, we simply hold it here in the Treasury because it is dead, for all practical purposes. Suppose that particular government does have a rather tight position with reference to its public debt and it finds itself in difficulty in getting additional funds. Would it not be possible by using some of those local funds to reduce the national debt, to loosen up conditions with the management of the debt of that particular country; and in that event, instead of being inflationary it would really be stabilizing and anti-inflationary?

Mr. DIEBOLD. I think actually in many of the underdeveloped countries, the whole financial mechanism is also underdeveloped, so that the same kinds of questions would not always arise as arose in Western Europe about the use of the counterpart funds. For instance, I think it could be argued that in Europe, even if you had a general rule against using counterpart funds to reduce public debt and only used the counterpart funds for a legislatively approved objective, this might in turn free local funds that could be used to reduce the public debt. It was often a problem to decide just what some of these transactions amounted to.

I think that while there is always this possibility in any situation, the main use that people have anticipated for local currency funds in the underdeveloped countries is not to exercise an influence on the fiscal position of the government, but to aid in the mobilization of local resources for development. You have underemployment in most of these countries, and if you can, draw this into the productive process, you are more apt to do it by lending this money to the local government than to use it in some fashion to reduce debts.

I think these countries are for the most part not overly burdened with national debts. I think their problem has been to get more, and one thing that they need to look for is ways and means of in fact drawing in real local savings. You have the familiar problems that because of the absence of domestic financial mechanisms, you sometimes have savings in the form of bullion or jewelry, or savings may be put not in any local obligations but in foreign obligations. There is often money in Swiss banks or American securities.

One of the problems that a lot of the underdeveloped countries have is in mobilizing more of this privately owned domestic capital. There may be situations in which reduction of the public debt serves the general purpose of development. I doubt one can generalize about this. Until you made this statement, Mr. Chairman, I had not heard of any great concern about the use of the local currencies in underdeveloped countries in connection with public debt. The concern has rather been with all this piling up. I think there is something like $2 billion so far unused. When can you use it without creating inflationary pressures or balance-of-payments pressures? Because after all, you bring people into the productive processes, they have income, what they are producing in the way of dams and so on is not going to show for sometime to come. They eat more; they want more. You have a further strain This is what you have to do; this is why development is a strenuous process.

The CHAIRMAN. That is what we had hoped these funds would be used for.

Mr. DIEBOLD. I think they are to a very considerable extent, sir.

The CHAIRMAN. If I may return to the line of questions which I started when I spoke about Japan, there is a strong movement for us to impose more rigid quotas or tariffs upon crude oil and residual oil which was affected by the situation in Venezuela. What effect do you think this would have on the orientation of Venezuela?

Mr. DIEBOLD. I do not know. The largest part of the Venezuelan export, I guess, is controlled by American-owned companies, and I assume that up to some point, unknown to me, they are in a position to direct exports toward one market or another. I am simply not familiar enough with the details of the very complicated structure in oil.

The CHAIRMAN. Have you studied the Latin American political situation at all?

Mr. DIEBOLD. In general terms, yes.

The CHAIRMAN. If Venezuelan exports to the United States diminished, it would diminish the total national income of Venezuela, would it not?

Mr. DIEBOLD. Unless there are equally good alternative markets.

The CHAIRMAN. What effect do you think this would have upon the policy of Venezuela toward the United States on the one hand, and toward the Soviet bloc, on the other?

Mr. DIEBOLD. I think it cannot have a good effect from our point of view. How bad an effect I am not in a position to judge.

The CHAIRMAN. To what degree do you think quotas on lead and zinc will affect some of the Latin American countries? I believe Peru is one.

Mr. DIEBOLD. I think Mexico in particular is hit by this, and I think that this is clearly damaging. I hope that we are dealing here with a situation in which it is not a matter of the Mexican Government saying, "Now, we must turn to someone else." This is, however, one more pressure, in my opinion bound to have undesirable political effects, in a situation in which it would be possible to promote both our foreign policy interests and the general economic health of the free world by other courses of action. It is that kind of a case, I think, from my limited knowledge of the lead and zinc situation.

The CHAIRMAN. Congressman Coffin has been one of the leaders in the movement to establish greater economic cooperation between Canada and the United States. Perhaps we like to follow this question up with some reference to what differences there have been in creating relations between the United States and Canada.

Representative COFFIN. Thank you, Mr. Chairman. I will just say that our United States-Canadian interparliamentary group just came back from 3 or 4 days in Canada this past week, and in one of the working groups, that has as its subject natural resources, lead, zinc, and oil were subjects of discussion. The Canadians are, of course, taking off the barriers on lead and zinc, and the oil situation has been at least temporarily relieved, but I think that this warrants a great deal of study, particularly in relation to our own Western Hemisphere neighbors.

The CHAIRMAN. With the advent to power of the Castro government in Cuba and some suspicion that Communist elements have a foothold in his government and in the new army, there is a movement started to restrict the importation of sugar from Cuba and to increase the proportion of the domestic consumption either from Puerto Rico or—perhaps, I should say, and—increase the share of domestic consumption, domestically produced, both of cane and beet sugar.

Have you given enough thought to the Caribbean situation to give us advice as to whether that would be a wise policy or not? It is a position we may have to face very quickly in the next few weeks.

Mr. DIEBOLD. No. But I should have thought that one of the arguments that might be involved here is not a general political argument but the question of how one handles the nationalization of sugar land in Cuba.

I remember that at the time of the nationalization of oil in Mexico, there were efforts, rather modest as compared to what might be done now, to penalize Mexican oil exports to the United States as a means—I think it was thought of as a means—of improving the terms of compensation or something of that sort. There may well be a problem of this sort with regard to Cuba.

How far one can get by this kind of pressure I do not know. I am inclined to be a bit skeptical about it.

I think there is an alternative problem that has to be considered with regard to Cuban sugar. If the analysis is correct that the land reform will in fact reduce production, then we may face a situation in which Cuba does not meet the sugar quotas it already has. But I think it is a very difficult judgment as to when trade pressure will produce desirable political results and when it will produce undesirable ones.

The CHAIRMAN. As a general rule, when pressure is applied, it is more effective if applied quietly and privately than publicly.

Mr. DIEBOLD. That has always been my experience.

The CHAIRMAN. Senator Sparkman?

Senator SPARKMAN. I have no questions, Senator.

The CHAIRMAN. One of the final questions I should like to ask is: When we started the Marshall plan for foreign aid, Western Europe was more or less flat on its back. Now Western Europe is going forward very rapidly, including France, and northern Italy, at least. In fact, recently it is going forward more rapidly than the United States.

Mr. DIEBOLD. That is right.

The CHAIRMAN. I wonder to what degree we should try to perhaps almost insist that Western Europe should bear a larger share of the burden of aiding the underdeveloped countries.

I remember when former Prime Minister Fanfani was in this country he made an appeal for Western European funds to assist the Middle East. It seemed to me a very good idea, and I was hopeful that Italy was suggesting it.

Now West Germany has become very prosperous. I wondered what the relationship might be as to taking up a portion of the burden which has now for 14 years rested exclusively on the shoulders of the United States.

Mr. DIEBOLD. I think that is a direction in which things are moving. To start with, a number of the European countries are doing a fair amount; that is, the French in particular have been investing rather impressive sums in French Africa.

The CHAIRMAN. Yes; in their own colonies.

Mr. DIEBOLD. How much this is net of repatriation of capital, I also do not know. The Italians have done something in Somalia, their ex-colony. The Germans have provided certain amounts of credit in various forms. They do not have so much of the running through the government, except the reparations to Israel, but through various kinds of commercial arrangements, some with official or quasi-official banking.

It is certainly my impression that more could be done. You mentioned Germany in particular and, as I recall the figures there, the piling up of reserves and the annual export surpluses far exceed any amount that is going out in various kinds of credit.

There is, I think, considerable consciousness in Western Europe of this problem. I think this is something which the United States can usefully explore, as I understand we are doing in the conversations about the International Development Authority. There would probably be advantages in doing more on a joint basis, and with a certain degree of coordination of activity. I do not think the idea has to be sold very hard. As I read Western European periodicals, I see repeated references to it.

You mentioned the Fanfani plan. There have been some dozen plans proposed in different countries, all reflecting a consciousness of this, and I think we can expect to see some willingness.

The CHAIRMAN. In doing this is it not necessary for the United States to maintain the same volume of foreign aid which otherwise it would make?

Mr. DIEBOLD. It has, of course, been a great question for a long time, of how much money can you usefully use in economic development. There has been concern with absorptive capacity, and such things.

I would think that within the practicable limits, the only limits that are likely to be tested, there is still room for considerable expansion of aid. And I would hope that if problems of economic development are as urgent and as large as they seem to most people who have studied them carefully, any share of the burden that Europe could take on would be regarded as a useful net addition, and not as a substitute for what is being done in the United States.

The CHAIRMAN. There is just one final question I would like to ask. Have you studied the management of the defense support funds in southeast Asia?

Mr. DIEBOLD. Not the management of them; no.

The CHAIRMAN. It has been charged that American aid has been given in the form of a favorable exchange rate, where let us say a dollar would be equal to 30 units of local currency; that the actual exchange rate would be only one-third of this, and a dollar would buy a hundred units of local currency. It has been charged, and I think not denied, that many tens of millions, perhaps hundreds of millions of dollars, have been pumped into these countries at the official rate of exchange, but that governmental officials there, or private business which have been licensed to take the defense support, have met their obligations in terms of the domestic exchanges and then sold the surplus of American dollars, and then have profited by two-thirds of the aid which we intended to give.

Have you been able to go into that?

Mr. DIEBOLD. No. I have seen those allegations, and I recall that some years ago there was a difficulty in Korea which hinged on the question of the willingness of the Koreans to devalue their currency in order to make it possible to continue using the official rate, but to make it more realistic.

The CHAIRMAN. We are very fortunate in having as our two colleagues here, members both of the Foreign Relations Committee and of the House Foreign Affairs Committee. I do not want them to betray any classified information, but if there is any statement they would like to make in this connection, I think it would be helpful.

Representative COFFIN. I do not think it is classified. I think the chief recent occasion has been in Laos. But I understand that during the past year they have substantially reduced this profiteering and made progress toward getting the currency on a standard basis for everyone. I think they have eliminated or are on the way to eliminating most of those abuses in import licenses.

The CHAIRMAN. In other words, the statement I made was true there? Was it true of Thailand?

Representative COFFIN. I think in most of the south Asian countries it has been true to a greater or lesser extent.

Senator SPARKMAN. This seems to me to be true in any country that has a weak currency or one that is changing. I do not see how you can very well avoid it.

It is true we have had some bad situations develop. We have checked very closely on it, and I believe considerable progress has been made in stabilizing the situation. But it seems to me it is almost unavoidable in a country that has a weak local currency.

The CHAIRMAN. Is it true that the American Ambassador to one of these countries refused to take any steps to correct the matter?

Senator SPARKMAN. I do not believe so. I know one was subjected to some criticism. He appeared before our committee and went through rather lengthly questioning prior to his confirmation in a new job, and he was reported out unanimously.

The CHAIRMAN. Are there any further questions?

(No response.)

The CHAIRMAN. I want to thank you, Mr. Diebold, for coming.

Your written statement will be inserted in the record at this point.

(The statement referred to follows:)

STATEMENT OF WILLIAM DIEBOLD, JR.[1]

Not so many decades ago it seemed reasonable to review the relation of the American economy to the world economy almost entirely in terms of exports, imports, oversea investment, and foreign debts. For some time now we have felt that a broader framework is necessary. Important as they are, foreign trade and payments are largely transmission belts and we need to look beyond them to the conditions at home and abroad that they connect. There is no logical limit to the "broad review of America's position and prospects in the world economy" that you have asked me to provide, so I have had to rely heavily on your invitation to "select." Still, the task remains formidable. Your purpose

[1] Mr. Diebold is director of economic studies at the Council on Foreign Relations, Inc., New York. The council is a private nonprofit organization. It takes no stand on questions of national policy. The views expressed in this statement are the author's only.

is to obtain a broad background for a series of hearings that will deal with certain aspects of the economic relations of the United States with the rest of the world. Therefore, even a selective review must be rather comprehensive. It cannot also be detailed, and I apologize in advance for the generality of most of the statements that follow. I am not presenting a statistical analysis or a series of projections. I am not trying to guess what will happen in the next few months or the next year. Instead, my statement calls attention to some broad lines of development in the world economy that seem bound to raise a series of questions for national policy during a number of years to come. They will, therefore, have an important influence on employment, growth, and prices in the United States, even though it is not possible to give precise indications of their effects in advance.

Because my statement must cover so broad a range of issues, you will not expect me to comment on pending legislation, appropriations, or other proposals. One can do justice to such issues only in more detail than is compatible with the kind of statement you have asked me to make. For the same reason, I shall be raising questions and suggesting possibilites, not proposng particular lines of action. I speak only for myself. I have no authority to speak for the Council on Foreign Relations or any of its officers, staff, or study groups.

I

The primacy of politics is not something that economists are always willing to accept, nor should they in every instance. But this survey would be out of perspective if it did not start with the dominant influence on the American economy that comes from the need to deter Soviet aggression and to prepare to meet it.

One has only to look at the level of arms expenditure in the United States, the Soviet Union, and other countries, and at the proportion of world resources going into military production, to see that major changes in the relation between the two great powers would have great economic consequences. But even if there is neither war nor disarmament we cannot assume that the economic effect of maintaining a high level of military preparedness will be constant. Changing military technology can spell the rise of one industry and the fall of another. It can radically alter the demand for particular raw materials and so affect the domestic economy, trade with other countries, and sometimes the attractiveness of investment opportunities in different parts of the world.

While the increasing cost of new weapons is well known, one often encounters the opinion that because destructive power is now so concentrated, the total cost of maintaining military strength is likely to fall. I am in no position to pass judgment on this mater, but one need not be an expert to see another possibility in the offing. There is much discussion of whether the United States should have the means of fighting sizable wars without the use of large-scale nuclear weapons and should be prepared to move quickly to fight relatively small actions in far places. To do this in addition to maintaining an adequate nuclear deterrent might well raise the cost of military preparedness. The Soviet threat and the choice of Western strategies can undoubtedly have a greater effect on employment, prices, and stability in the American economy than changes in the more obvious elements of our foreign economic relations. After all, a 10-percent change in the military budget equals more than our total annual expenditures for foreign aid and a 5-percent change exceeds our whole nonmilitary aid. The goods and services, for which our annual military budget provides, considerably exceed our total foreign trade, exports plus imports.

Concern with military potential is only one of the elements in the now familiar debate about the comparative rates of growth of the Soviet and the American economies. Your committee already has the matter under study and I cannot at this point add anything to the detailed discussion of data. However, since we shall have this problem with us for some time to come, it would be well to clarify some of our thoughts about it. Some times oversimplified and rather crude camparisons are set forth which do not help us to understand these important issues and may prove misleading to people in the rest of the world. We need to sharpen our concepts of growth and look more critically at the relation between economic size and military and political power. We should not leave out of account either the other countries of the free world or China and the European satellites. When it comes to drawing conclusions that may affect national policy, two rather obvious points need to be borne in mind: First, we can have a major influence on only one side of the comparison, but that side includes not only the United States but other countries in the free world that have great potential for growth; second, while there are important reasons to be concerned with the growth of the American economy, too much is at stake to permit our policies to be dominated by comparisons with the Soviet Union. The "growth race" is important, but there are dangers in letting it acquire excessive symbolic importance.

In the last 5 years the U.S.S.R. and China have added a new complication to our problems of foreign economic policy by offering military, economic, and technical aid to underdeveloped countries while expanding trade with them. In these matters the Communist powers are latecomers. They have thereby gained some political and psychological advantages. Some elements of their aid and trade policies seem designed to exploit frictions that have developed during the many years that the United States and other industrialized countries of the free world have been engaged in this kind of activity. Concentration of aid has given the U.S.S.R. a strong position in a few countries, but taken as a whole the Soviet program is still quite small compared to what the Western countries are doing. However, the U.S.S.R. has the means of expanding its trade and aid program substantially if it judges the gains to be worth the effort. To be sure, Moscow may change its policies or make enough mistakes to throw away its advantages; Peiping may find its own economic difficulties too great to permit expanding its outside activities. But it would unwise to build American policy on any such assumptions. Instead, we had best expect increased Soviet and Chinese economic activity in international trade and finance to be a continuing factor in the world.

There will then be continuing problems of what policies the United States should follow toward this Communist activity. How great a danger is there in it? Are there means by which the underdeveloped countries can extract the maixmum benefits from this additional aid while safeguarding themselves from Soviet pressure and influence? When should the United States make counter offers? When should we stand ready to replace Soviet aid if it is withdrawn or a country wishes to give it up? Do new problems arise in giving American aid to a country that also gets aid from the U.S.S.R.? Should the United States change some of its own aid practices to compete more effectively with the U.S.S.R.? Do we need new trading agencies to offset some of the advantages of Soviet and Chinese Government trading? These questions are only a beginning. Many of them probably cannot be answered in general terms. But they indicate lines along which our thought will have to move. There is also a fundamental consideration to be kept in mind: the risks of damage from Communist trade and aid activity can be reduced by measures that improve the operation of the economy of the non-Soviet world. By reducing vulnerabilities—whether they be inadequate growth, a lack of capital, persistent or sporadic surpluses, or whatever—we reduce the opportunities for the Soviet Union to expand its influence by economic means.

Along with this new set of problems, an old and familiar one that has given us headaches in the past will need to be looked at again. There is a growing interest in Western Europe, Japan, and perhaps the United States, in trade with the Communist countries. Some of this is political on the part of people who believe that trade will reduce tensions. Some of it is clearly commercial. While the economic importance of this trade for the United States may not be very great, there may be some advantages; in any case American producers and traders are likely to show some interest, particularly if they see foreign competitors establishing regular relations with Communist countries. We shall probably need some fresh assessments of familiar economic and political arguments. For instance, in conjunction with our allies, we might well look at the bearing of this trade on Soviet growth, at its potential economic importance to certain countries of the free world, at the validity of our distinction between strategic and nonstrategic goods, at possible ways of controlling or organizing trade, and at the political implications of fostering or discouraging it.

II

The desire for economic improvement in the tremendous part of the world that is usually called underdeveloped now has a high place in any agenda of economic problems facing the United States. The salient features of the problem and the range of considerations that make it important to the United States are well known. Later this week you will devote a day to a discussion of some of the problems of economic development, and perhaps that session will provide an occasion to raise some of the intricate problems that I shall have to pass over—such as the means of mobilizing local capital, the possibilities of increasing private investment, the relation of private and governmental action here and abroad, and the relation of population growth to economic development. Here I can only comment broadly on a few loosely connected issues and trends.

In the course of the last few years, we, in the United States, appear to have come to the point of recognizing that for a long time to come this country is going to be involved, in one way or another, in the economic development of foreign countries. We had better be sure, therefore, that our policies and methods, some of which were introduced on other assumptions, or even improvised, are reasonably well suited to the long haul. This does not mean that the issues are not timely, urgent, and critical. They are, but we should be sadly disappointed if we thought that a massive effort by all concerned would solve the basic problem in a few years.

Economic development is not only a long process, but a complex one that contains a wide range of problems. As development proceeds, problems change. Not all the problems result from lack of development or from the failure of an economy to begin moving rapidly. Quite the contrary. Many of the most difficult problems come from the acceleration of development. The rapid pace of growth, not the absence of it, is one of the principal causes of inflation and balance of payments difficulties in some Latin American countries, for instance. Part of India's difficulty in paying for imports results from a boom in the private sector of that country's economy.

Several inferences for policy can be drawn from the fact that "economic development" is shorthand for a wide range of problems that will last a long time. One is that we are likely to be misled if we think of economic development in terms of formulas or patterns. There are many common problems, of course, but the best combination of measures will differ from country to country and from time to time. Sometimes the first emphasis should be on agricultural development, sometimes on industry. The main need may be to get outside capital into the country or it may be to find ways of using the capital that already exists effectively. It follows that effective aid to economic development is apt to require a wide range of devices; concentration on one or another of the familiar forms of aid is likely to leave us ill equipped to meet important problems. It is also very desirable to have a broad base of resources, skills, experience, and interests. Industrialized countries, other underdeveloped countries, private capital, and international organizations, all can play useful parts, and do. Though there cannot be much quarrel with this description of needs, it seems clear that we have not yet secured the widest base for aid to economic development, provided a full array of means, or fully explored the possible combinations of methods.

There are however, some recent favorable developments in these respects. The growing importance of the Development Loan Fund, the inauguration of the U.N. special fund under Paul Hoffman, the increased activity of the International Monetary Fund, and the International Bank for Reconstruction and Development all move in this direction. Discussion of the proposed International Development Authority seems to be focusing on the means of bringing Western European countries more fully into the process of aiding economic development. Some of these countries are already providing aid in one form or another, but it looks as if many of them have the means to do more. Skills and experience are involved, as well as funds and goods. While multilateral aid is not always preferable to bilateral aid, the increased interest in international arrangements seems to have a fairly solid basis. A more economical disposition of resources may be achieved through broader participation. There are increased opportunities for developing countries to help one another especially through the exchange of specialists and experience. In some circumstances an international agency can help greatly in exercising some of the pressure that is necessary for hard decisions about development. The Fund and the Bank are playing a valuable part in this. It should not be a surprise, however to discover—as some recent Latin American reactions remind us—that there are times when it is no easier to accept the political consequences of financial discipline under international pressure than under any other kind of pressure.

Though the growing complexity of the free world's aid-giving machinery has caused some people qualms, it also has its good aspects. Look, for example, at the way different kinds of aid were combined to help Turkey and India during 1958. Britain, Canada, Germany, Japan, the United States, and the World Bank concerted their efforts to help India meet its balance of payments difficulties. American aid to India comprises DLF loans, Export-Import Bank loans, and Public

Law 480 sales. Turkey was helped by the International Monetary Fund, the United States, and several Western European countries acting through the EPU. The American share of that operation involved DLF loans, Public Law 480 sales, defense support grants, money from the contingency fund, and postponement of installments of past debt. Assuming that it was wise to provide aid in these cases, it looks as if the multiplicity of forms made it possible to accomplish things that might otherwise have been very difficult or impossible.

Aid is, of course, only one part of the problem of economic development and only one of the ways it affects the American economy. Crucial as foreign assistance is, the main job of development must be done by the people of each country. One of the main assets a country has to sustain its own economic development is its ability to produce goods for export. If the United States accepts the fact that it has an interest in the growth of the underdeveloped countries, then it must give at least as much attention to trade relations as to ways and means of aid. A strong underpinning in provided by the fact that a high level of economic activity in Western Europe and the United States automatically produces a strong demand for the principal products of the underdeveloped countries. If we assure the continued growth of the American and Western European economies, we can be reasonably optimistic about the ability of the underdeveloped countries as a whole to increase their export earnings. But this does not mean that each and every one of them can count on that, or that the longrun upward movement will be stable.

Some countries may have trouble maintaining exports while meeting rising domestic demand. Some commodities may be plentiful enough so that their producers may suffer some disadvantage in the terms of trade. Technological change has a great effect on raw materials markets and can change demand rather more rapidly than is convenient for suppliers. In 1937, rubber, silk, and tin accounted for nearly 50 percent of the value of U.S. imports of crude materials (excluding food); last year they were less than 15 percent. Though our economy has expanded greatly, and the value of raw material imports has nearly tripled, we import substantially less of each of those basic products than we did 20 years ago. We cannot gear technological innovation to the interests of underdeveloped countries, but it is of some importance that we should try to anticipate the effect of significant changes, especially on countries that depend heavily on sales of a product that is due for slow or rapid decline.

There is also American raw material protectionism to be reckoned with. The United States is a major raw material producer. Over a wide range of products domestic output can hold its own with potential imports. But domestic producers of some raw materials feel threatened by imports. Sometimes only a portion of the producers in an industry are affected and the level of imports determines the size of the domestic industry, not its existence. Sometimes the impact is broader and a large part of the domestic industry is clearly in decline. Sometimes what is at issue is primarily a price structure. Our record of public policy has been mixed. Recently, partly under the impact of the recession, we have extended protection, notably for oil, lead, and zinc. (Ironically, but not surprisingly, the main effect of this protection is felt after the recession.) Our agricultural policies make tariffs or quotas necessary on a number of products. In other cases, domestic producers have failed to get the protection they sought. It would be out of place to enter into the details of particular commodities. The general problem is simply that when an issue of this sort is being considered in the United States, it is important to realize that in addition to the usual arguments about the pros and cons of protecting high-cost producers, we ought to take into account the effect of contracting the market for the products of underdeveloped countries and so adding to their problems of economic development. The result is bound to be a series of indirect effects on other elements in the American economy.

Another set of factors concerning raw material trade bears on the notorious instability of world markets for these products and the troublesome consequences for the producing countries, especially those which depend heavily on income from sales of a few products. The decline in raw material prices after Suez revived an old interest in possible stabilization measures. Moved in part by its concern for the course of events in Latin America, the U.S. Government has taken a more sympathetic view than it often expressed in the past and went along with an agreement among producing countries aimed at holding coffee off the market. Although raw material markets are now improving once more, we can reasonably expect to hear more of these matters in years to come. That the U.S. Government should be willing to examine these problems with producing countries is certainly desirable. It would be unfortunate, however, to fool either ourselves or them with the idea that the prospects of effective longrun action are good. Emergency action may always be possible but whether acceptable, longrun stabilization measures can be devised is much more doubtful. This is not one of those cases in which the economists have a selection of good, workable arrangements to propose if only untoward political obstacles were removed. On the contrary, while there are scores of proposals, there is little agreement. This is one of the most troublesome areas of economic analysis marked by great differences as to what is desirable and also as to what can be accomplished. There is no room here for a close analysis of these matters, but a few questions will suggest the range of difficulties.

What is to be stabilized? Prices, foreign exchange earnings, or the income of producers? The problems and the means of coping with them will differ substantially according to the answer.

Do raw material-producing nations really want "stability" or do they want a floor put under the markets, without a ceiling? Both the kinds of machinery that could be used and the willingness of consuming nations to accept such measures might depend on the answer.

Can effective stabilization measures be devised that do not seriously interfere with longrun changes of price and volume of trade of the sort that are necessary if markets are to serve their purpose of guiding production?

Buffer stocks have appealed to many as the best way of moderating raw material fluctuations, but there is a nagging doubt about the workability of the neatest schemes in the face of producer pressure to prevent the liquidation of stocks once they have been accumulated. Some have advocated special loans to producing countries when surpluses appear that would keep up their current income and enable them to hold supplies off the market. Because of the difficulties of getting international agreement, national action in both producing and consuming countries has appealed to others. Countries as different as Ghana and New Zealand have done reasonably well in stabilizing returns to domestic producers in spite of fluctuations in world prices. But continued success depends on reasonably good world markets. Some countries are prevented from taking effective shortrun stabilization measures because they lack storage facilities. Sometimes a relatively small shift in world demand has greatly magnified effects on the economy of a small nation heavily dependent on one export. This was part of the difficulty over Burmese rice a few years ago.

The United States is also an important exporter of raw materials and food. The sale of agricultural surpluses for local currency has become a major form of American aid. We have been made aware of the difficulties of avoiding the displacement of commercial trade by these shipments. We may find a growing problem of the relation of aid shipments of such products as rice and cotton to the opportunities that underdeveloped countries have to sell their own expanding output of these products. Our calculus must somehow be large enough to relate the advantages of giving rice to India and Indonesia, for example, and the disadvantage of narrowing the market for rice exports from Burma or Thailand.

We need also to think about the expansion of exports of manufactured products from underdeveloped countries. This trade may first be important in nearby markets in other underdeveloped countries. However, it is only reasonable to expect that in time sizeable quantities of cheap goods will make their appearance in American and European markets. Some of this will be made possible by the low wages that will prevail for some time in most underdeveloped countries. We can look forward to problems comparable to those we have long faced with Japanese goods and that England now faces with textiles from India and Hong Kong. We are doing nothing more than temporizing with the Japanese problem by so-called voluntary quotas and the same method has caught on in Europe. We do not seem rich in ideas about what to do next, but unless we can find some means of permitting developing countries to make the most of these assets we shall be further complicating the problems of economic development.

Another trade problem concerns protectionism in the underdeveloped countries. The justification of some protection for an infant industry is widely accepted by economists and has deep roots in American tradition. But before the phalanx of factories from San Francisco to Magnitogorsk and from Stockholm to Milan, almost every industry in an underdeveloped country may look like an infant industry and some kind of blanket protection is likely to be tempting. There is considerable risk that the governments of some underdeveloped countries, under familiar economic and political pressures, will indulge in protection on a scale that will damage their own interests and in the process slow, or at least distort, their own economic development instead of fostering it. No one has ultimate wisdom in this matter; good fortune and economic expansion may serve to overcome some serious mistakes. GATT provides some help. The other international agencies are in a position to take account of commercial policies in their activities in the underdeveloped countries. The United States and Western Europe have a part to play because of their intimate links with the underdeveloped countries through aid, trade, and private investment. Pursuit of good examples is not the most marked characteristic of nations and it would be unrealistic to call on the advanced countries to conduct themselves as paragons, but their chances of success in this matter will be helped if their own protectionism is kept to a minimum.

III

If we turn away from the endless panorama of the problems of the underdeveloped countries and look toward Europe we see not the end of a story, surely, but the end of a phase and the opening of a new stage. The great European problems of the postwar decade are behind us: recovery, the dollar shortage, tight restrictions of trade and payments, the difficulties of removing wartime controls. New heights of production and consumption, coupled with a great improvement in balances of payments, have now led to a considerable measure of convertibility. Of course Europe continues to have economic problems: some recent stagnation or recession; the coal surplus; uncertainty about the area's longrun energy position; Algeria's continuing threat to French financial reforms; the underdeveloped areas of southern Europe; inflationary pressures. The big difference is that these problems arise now against a background of prosperity and growth. The picture is not only greatly changed from that of 1947, but it is a different Europe from that which existed 14 years after the end of the First World War, in 1932.

One mark of the improvement of the European economy was the slight effect on it of the last American recession. That was partly, of course, because of the character of the recession, but already in 1953–54 the European economy had weathered an American slump with less damage than was expected. The fears that existed at the end of the war that Europe's economy would always be at the mercy of fluctuations in the United States and would be buffeted seriously whenever there was a drop in economic activity here should by now have disappeared. With them should have disappeared the arguments that Europe's prime need was for a series of controls capable of putting buffers between it and the United States. Another set of measures, those based on assumptions of a permanent dollar shortage, are also due for scrapping. Since convertability several European countries have taken important steps to liberalize their trade with the United States. There is some distance left to go and the leader of the American delegation to the last session of GATT was quite right in calling for the removal of remaining discriminations against dollar goods, since these no longer have any justification on balance of payments grounds. This kind of progress will be a direct advantage that the United States can gain from the improvement in Europe's economy. In addition, we can hardly count it as anything but a gain for our broad national interest that Western Europe can play a greater role in the world economy.

One of the effects of Europe's expansion has been the stronger competition that the American exporters are meeting in markets around the world. This is inevitable. We cannot have a healthy Europe without it. While certain export markets may be lost for good, I have reasonable confidence in the ability of American producers to meet a good bit of competition once they face the challenge. European recovery has also played its part in the gold flow from the United States. It is to Western Europe that the gold has gone. This is probably an important longrun gain because a Europe with good reserves will be more stable and better able to hold its own place in the world. It is through such developments, supplemented by measures like those increasing the reserves of the International Monetary Fund, that we create the conditions in which current and future difficulties can be met as more or less normal problems rather than as emergencies.

The improved position of Western Europe also raises the question whether the countries of that area can be expected to play a greater part in meeting the costs of some of the common free world measures. I have already mentioned the possibility of mobilizing more European capital for economic development. Edward Bernsteins' analysis of the gold flow from the United States points a finger at U.S. military payments in Western Europe as one of the factors that may have to be adjusted to time to prevent the outflow of gold from becoming a source of weakness. This suggests a reexamination of what NATO used to call burden sharing, to see whether a pattern of payments established some years ago is still the most desirable. This is clearly a very delicate issue, involving strategy as well as economics. It suggests other questions about the relations of defense and trade that are likely to be with us for some time. The recent Buy American cases concerning heavy electrical equipment and past arguments about watches and other products are familiar examples. There is a cogent Canadian argument that a single land mass with much common air defense is not easily divisible into two economic units on defense grounds. The conferences about shipping a few weeks ago suggest some of the complexities of defense economics. European complaints seem to have been directed not only at American subsidies and cargo preferences which have been defended largely on strategic grounds but also at the increasing use of "flags of convenience" which are regarded as an economic threat to some of our allies. To know where we stand we shall have to keep reviewing the economic requirements of our defense needs as strategy and military technology change. With this must be coupled sensitivity to the political requirements of our alliance policy. Throughout we have to weigh the arguments for protecting or subsidizing domestic production of strategic products against the long run need to make the most economical use of resources and to maintain the highest possible level of economic health and activity throughout the free world.

Western Europe has not only gained new economic strength, it has taken on a new shape. At its core is the Common Market—the European Economic Community, comprising France, Germany, Italy, and the Benelux countries. Though the reduction of trade barriers among the six countries is scheduled to take more than a dozen years, the initial response of business has been so strong that we may find the process speeded up. In any case, even if the original schedule is kept, and though there are always possibilities of failure, we must base our policy on the assumption that a customs union will be formed with a common tariff—and perhaps eventually a common commercial policy—toward the outside world. This is an extraordinary change from the traditional Europe. While keeping a clear eye out for the inevitable difficulties and for the effectiveness of the forces that will resist change, one can hardly fail to be rather optimistic about the longrun effects of this economic union.

There will, however, be some problems for American policy, and perhaps some difficulties for some parts of the American economy. Some American exports will be put at a disadvantage; how serious this will be is hard to judge in general. The Common Market countries have professed a willingness to lower barriers to trade with the rest of the world, but, as in most countries, there are conflicting internal forces. It is of some concern to the United States that internally the Common Market should function as freely as possible, and that its external trade barriers should be low. The principal means we have of pursuing this aim is by tariff bargaining in GATT. The Europeans say they are ready for this, but I get the distinct impression that the importance of the result will depend on the willingness of the United States to bargain seriously which means to offer some real concessions in return for better access to the enlarged European market.

Later this week, when you discuss American relations with the Common Market, you will undoubtedly get into the intricacies of the various free trade area proposals. Essentially this is a matter of the impact of the Common Market on the neighboring countries. This is not just Britain; Switzerland, Austria, and Denmark have an even greater interest, so far as trade is concerned. It is certainly important to the United States that a serious economic and political split in Europe should not result from the creation of the Community. It is not so easy, however, to see along what lines an agreement can be reached. We have also to weigh the effects on American foreign trade of further removal of trade barriers among the European countries against extending the area of discrimination against American products that this entails. The matter grows more complex as we explore the possibility of some kind of association of the British Commonwealth countries and their system of imperial preference with the new European arrangements. We may be faced with some hard choices if, instead of a true free trade area with all internal barriers removed, a series of special arrangements should be proposed, in which different countries would be associated with the Community in differing degrees and special understandings would cover trade in certain products. This is already the case for agriculture. Such a development might begin to look like the kind of worldwide trade discrimination we have long sought to eliminate. Convertibility has removed one of the arguments for discrimination that was most often advanced in the past and at the same time has reduced some of the risks of trade distortion from the creation of regional or other selective groupings of countries. We shall have to look very hard to determine how seriously our interests are affected by these possible developments and what courses of action are open to us. The commitments that most free world countries have under GATT are gaining in relevance and it is likely to seem increasingly important to the United States to maintain them and increase their effectiveness.

The creation of the European Common Market has repercussions beyond the potential free trade area countries. Africa is a clear case. French and Belgian territories are linked with the Common Market while British and independent countries are outside it. If matters are left this way there are likely to be implications for relative rates of development and there would be some danger to the growth of closer relations among the African territories. There is evidence of some concern with this problem among African leaders who may take the initiative in working out relations among themselves. In Latin America there is worry about the preferred position of some competing African producers inside the Common Market's tariff wall, and about the bargaining position that Latin America will have in facing a large European bloc. In Asia there is also concern about these matters, perhaps especially in India and Japan. Here again GATT is relevant because up to a point the Common Market countries are bound by GATT rules and because in that setting the outsiders have a chance to join forces in presenting their cases.

Partly because of what has been happening in Europe, there is a stirring of interest in other parts of the world in the possibility of forming new regional groupings. Several proposals are being studied in Latin America; a limited arrangement has been approved in Central America. The United States recently reversed a policy of long standing and lent support to the drafting of a charter for an Inter-American Development Bank of which this country would be a member. The President has indicated that we would aid a Middle Eastern bank of the same sort, but without becoming a member. Various kinds of African development organizations have been proposed. We may expect to hear more of this kind of thing. Quite a wide range of questions opens up for the United States, as well as for countries that would be directly involved in these groupings. The applicability of Western European models is probably quite limited. In most underdeveloped areas, for instance, while there would be gains from liberalization of trade and payments, an effective integration arrangement would have to be more closely geared to investment and development plans. Difficulties from divergences in monetary and fiscal policies might be much more serious than in Europe, where they have not been negligible. There are unresolved questions about whether a development bank or some other regional financial arrangements would promote broader measures of integration.

Only rarely is the case for regionalism based on a clear-cut demonstration that a certain grouping is the natural economic unit in which to carry on certain functions. Usually the argument is linked to political considerations or is based on simple pragmatism: These countries can agree among themselves, a larger group could not. If by getting together with a small group of others, countries can go farther along the path of liberalization and sensible allocation of resources than they can on a national or global basis, then there is a good case for seriously looking at regional possibilities. There are also some advantages in having each country's economic policies judged to some extent by its peers who are immediately associated with it in some common venture and not only by the more remote officials of distant countries or international agencies.

At the same time, regional economic relations have their price. I have indicated some of the issues that arise in my remarks about the European Common Market. It is not only the outside countries that are affected. The members of the regional arrangement may find themselves deprived of some of the benefits of wider economic relations if they are tied too closely to a grouping that is restrictive in important ways. This is not an issue that can be resolved by generalities; it depends very much on circumstances and on the terms of particular arrangements. We shall probably have to give much attention to such questions in the future.

The United States probably does not have to make a sharp choice between regionalism and globalism. It can look sympathetically on efforts of countries to work out problems for themselves by regional groupings, and may be able to encourage or help some of these efforts. But it is also important to insist that regional arrangements be looked at in a global—or at least free world—perspective and that they be subjected to rules of the sort laid down in the GATT agreement. More than rules are involved; the constant testing of the actual working of the arrangements by discussions and negotiations in international forums is also of great importance. We must be concerned, too, about the effect of regional developments on our own trading and investment interests, and on the position of other countries that are left outside. Some of these will be small countries, with limited bargaining power. Others will be countries that for one reason or another, sometimes political, cannot join particular groups but ought not be deprived of opportunities to expand their economic links with the world. Among the great trading nations Japan is perhaps the one beside the United States that is least apt to find a place in a regional trading arrangement. It is quite important, politically and economically, that the world economy should be able to accommodate single countries as well as regional groups, and without great disadvantages. Eventually there may also be a question about American membership in some regional group—but to explore that hypothetical possibility now would require far more space than is available.

IV

This survey has had to be conducted at a level of generality that forbids the drawing of any sharp conclusions. It has been something of a catalog of major problems and trends, each of which must be examined more fully than I have been able to this morning to judge just what its effects are likely to be on employment, growth, and prices in the United States. Even so, this statement has omitted a number of important issues. For instance, I have said almost nothing about the relations of the United States with such important countries as Canada and Japan, which present a whole series of problems quite different from one another. Private investment needs to be examined, not only as to possible future amounts and direction, but in its relation to domestic needs, imports, and exports; when we talk about the American economy we have increasingly to keep in mind that an important element in it is the economic activity of American firms abroad. Agricultural problems are global, not just national; the international trade in farm products is to a high degree controlled by governments. What will happen to this important segment of the world economy? What are the implications of widespread agricultural protectionism for the industrialized countries and the underdeveloped ones? The world's energy supply presents an interesting series of problems: How long will the oil surplus last? How much use can be made of nuclear energy how soon? The use of local currency sales and loans has eased a number of aid problems, but it is piling up questions for the future. It is easy to add to the list.

If there is one general observation that can be drawn from the wide range of diverse developments that this survey has mentioned, it is that the world economy is in the process of substantial change, as it has been so often in the past. Some of the mainsprings of change lie outside the United States. Up to a point the United States can influence the course of economic events but only rarely can it control them. In a broader sphere, the effectiveness of American foreign policy is linked both with our economic strength and with the growth and proper functioning of the free world economy. The economic welfare of the United States is, in turn, affected to a considerable extent by what happens in the rest of the world. In this situation we are, and will continue to be, faced with a series of choices. They may look very different from one case to another, by and large most of them will have in common the fact that they are choices between flexibility and rigidity. Usually the economic advantage for the United States and also the ability of this country to influence the course of events abroad will lie on the side of flexibility. This has been apparent for a long time in our domestic economy. We have not always applied the same principles to our foreign economic relations, but there is increasing reason to do so.

The CHAIRMAN. Tomorrow we meet here in this same room at 10 o'clock to discuss the question of balance of payments and the significance of international gold movements. The discussions will be from Prof. Robert E. Baldwin, of the University of California; Prof. Charles P. Kindleberger of MIT; Mr. Walther Lederer of the Department of Commerce; and Prof. Wilson E. Schmidt of George Washington University.

We stand recessed until 10 o'clock tomorrow morning.

(Whereupon, at 11:50 a.m., Monday, June 29, 1959, the committee recessed, to reconvene at 10 a.m., Tuesday, June 30, 1959.)

# EMPLOYMENT, GROWTH, AND PRICE LEVELS

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**TUESDAY, JUNE 30, 1959**

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to adjournment, in room P-63, the Capitol, at 10 a.m., Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas and Javits, and Representatives Coffin and Widnall.

The CHAIRMAN. Gentlemen, the hour of 10 o'clock has come. I think we can open our hearing.

I want to thank you gentlemen for taking the time to prepare your papers, some of which I have had a chance to look over.

Mr. Lederer's paper is apparently basically factual and I think perhaps we should begin with him and then pass to the other papers, which are analytical and synthetic.

We are very glad to have you, Mr. Lederer.

Let me say that the papers will be printed as you submit them, but perhaps it would be well if you talked informally, not to exceed 10 minutes apiece. Then there can be colloquy between the members of the committee and the members of the panel.

## STATEMENT OF WALTHER LEDERER, OFFICE OF BUSINESS ECONOMICS, U.S. DEPARTMENT OF COMMERCE

Mr. LEDERER. I have brought some charts along, which are also included in the statement here, which make it a little bit easier to see the situation.

The first chart I have here is the balance of payments in 1958. For those who are not entirely familiar with that kind of statistic, I might say that the balance of payments is based on a double entry bookkeeping system with debit items on one side and credit items on the other side. What this chart shows is roughly the magnitude and the kind of items that go on the two sides of that account.

I might say here that the balance of payments includes not only items which require actual payments, but it includes also items which represent transfers of any kind of resources, goods, services, or capital assets.

Suppose, therefore, that we export something under a Government aid program. The item would appear here in the exports, and it would appear in the same magnitude over here under Government grants or Government loans, for instance.

The important thing is understanding this kind of data is that the two sides of the balance sheet are not entirely independent of each other. Very often if one item is changed on one side, a corresponding item is changed on the other side, and the balance is relatively little affected.

In 1958, you may see that our payments were larger than our receipts as we define it here. The difference represents the amount of gold or dollars which we transferred to foreign countries. In 1958, the magnitude of this balancing item here was $3.4 billion.

You may also see on that chart that merchandise imports were considerably smaller than merchandise exports. Yet—and this is something which is often forgotten—even though we have an export surplus, we had a balance-of-payments deficit. The reason is that the merchandise imports comprise less than half of our total payments, while exports comprise somewhere around 70 percent of our receipts.

The next chart shows the development of total payments and receipts since 1946. The figures are quarterly, seasonally adjusted since 1950. The red line represents the payment; the green line the receipts.

You may see that, all in all, roughly up to the end of 1949, the time of the devaluations of the British and other foreign currencies, our receipts exceeded our payments, and foreign countries liquidated their reserves to make up that difference.

Beginning with the end of 1949, and practically all through that period to now, with two exceptions which I am going to mention in a minute, our payments exceeded our receipts. That is, we paid out more than we received back. The difference was added by foreign countries to their reserves.

There were two small exceptions. One was, shortly after the beginning of the Korean war, when there was some lag in foreign purchases, that resulted in a small reduction of the reserves these countries had accumulated earlier in that period. The other interruption was in the year following the Suez crisis.

You may see that the gap between payments and receipts was around $4 billion during most of 1958 and probably is somewhat higher at the moment; that was substantially more than in any other period we had since the war. The latter part of 1952 and the early part of 1953 was perhaps the one period that came closest to it. [Indicating.]

At that time the rate was somewhat over $2 billion. So now the excess of our payments is about $2 billion more than it was in 1952–53.

As for the reasons, this chart, as you may see readily, cannot explain why we have that big gap. The reason is that if you start out with 1957, then you will see that our receipts fell very substantially, much more than our payments. But if you go back a few years, then you might see that our payments increased more than our receipts. So you see it depends entirely upon the base period and perhaps upon the points that you want to prove, which period you choose. You can prove either point that you want to make.

However, perhaps a somewhat different approach would be to look who got that gold and dollars that we paid out. That is shown on the third chart here, where you see three lines. The upper line here shows the economically advanced countries, which include here most of Western Europe (with the exception of Spain, Portugal, Turkey, and Greece) and Canada and Japan. The other countries are included in the record line, and the international institutions—that is, the Monetary Fund and the International Bank—in the lower line.

You can see that practically the whole gain in foreign gold and dollar reserves was by the economically advanced countries. The less developed countries did not gain very much, and I should say that a very large part of that gain accrued to very few countries, like Venezuela, for instance.

The international institutions got their big contributions in 1946 and 1947. You see that their gold and dollar balances dropped in 1956 and 1957, and that was due to a large extent to their loans to the advanced countries here, during the year after Suez.

The problem now is, of course, what is behind the gain of the advanced countries.

This chart seems to suggest that there has been a change in the economic position of the United States, vis-a-vis the other advanced economic countries. That change has not shown up as drastically before 1957. The reason was probably that these countries had a very high level of economic activity. They were mostly busy producing for themselves, and the amount of resources that they could devote to the accumulation of reserves was relatively limited.

In 1957, their economic activity flattened out. It did not actually drop much if at all. But that gave them the excess capacity to compete more energetically on various markets, and it is then, probably, when our exports felt the impact of that increased competition, and not only our exports but also our imports.

Generally speaking, if you have a balance-of-payments disequilibrium, it does show up not only one one side of the accounts; it shows up on both sides of the accounts.

At the present time, it seems that some of the factors which caused that big disequilibrium in 1948 were temporary factors. There are certain kinds of exports which we know will probably go up in the near future: Cotton, for instance, is one of them. Airplanes is another one.

There is also good reason to believe that the expansion of economic activity in Europe will again lead to a rise in our exports. But I tried to estimate the effect of these two types of development, and my conclusion would be that they would not be sufficient to bridge the balance-of-payments gap. In other words, if I add up on the basis of historical parallels, and on what else we can find out, it seems that the deficit which is now well over $4 billion, might be cut by half, but not by much more than that, as far as we can see.

That means that even after foreign countries resume their economic activity, there will still be a substantial gap, and the problem is, in effect, that this gap has to be bridged or reduced if our liabilities to foreign countries should not rise, vis-a-vis the gold stock that we will have.

That is a problem, that has to be arranged in the relatively near future. There is a longer term problem here, and that is due to the probability that foreign countries presumably will continue to raise their reserves; and that too may result in an increase of our liabilities or a reduction of our gold stock.

Even if foreign reserves increase only as much as they did here in the period 1955–56, which was not a very high rate, but it was a rate which permitted an increase in international trade and the further liberalization of foreign exchange restrictions—even if that kind of rate of growth in foreign exchange reserves continues, it would mean that our liabilities would rise or our gold stock would decline, and that creates some problems which probably, earlier or later will have to be faced.

The CHAIRMAN. Mr. Lederer, would you answer one or two questions based on your paper.

Do your figures go beyond December 1958? Have you been able to carry your projections into 1959?

Mr. LEDERER. These figures go through the first quarter of 1959.

The CHAIRMAN. Does it follow from what you say that our military aid to Europe has largely permitted the European countries to build up their claims against the United States?

Mr. LEDERER. Well, you see, the military aid itself consists entirely of goods and services. It shows up on both sides of the balance sheet, and this item on this side is the same size as on the other side.

The military aid itself did not distribute any gold and dollars to the European or any other countries. The only question you might have is whether these countries would buy any part that they now get for nothing. If they would buy any part that they now get for nothing, then, of course, they would have less gold and dollars. But the way it is now, it does not directly contribute to their gold and dollar resources.

The CHAIRMAN. How does it happen that the net claims of the rest of the world against the United States ran at the rate of $4 billion last year and you say slightly more than that rate for the first part of 1959? How does that come about, when our merchandise exports have exceeded our imports? And I suppose travel allowances would not——

Mr. LEDERER. The travel is in this item here. It is roughly at the rate of $2 billion, including transportation.

The CHAIRMAN. So that would not offset this figure?

How is it that your right-hand table exceeds the left hand?

Mr. LEDERER. It falls short.

The CHAIRMAN. Yes. How is it that Europe has accumulated these claims against us and is continuing to accumulate them at the rate of $4 billion a year?

Mr. LEDERER. Well, there are two ways: One is that in the transactions with Europe itself we pay out more than we get back; the other is dollars which Europe gets by way of third countries. We pay out more on all of these items.

The CHAIRMAN. But not on the exchange of merchandise?

Mr. LEDERER. No.

The CHAIRMAN. Not even on the exchange of merchandise plus travel as compared with merchandise plus what little travel there is on the other side?

Mr. LEDERER. Well, you have to take all of these items together.

The CHAIRMAN. Yes, but what I am trying to get at is, what are those items which cause the European countries to have a net claim against us?

Mr. LEDERER. The trade at the moment is nearly in balance with Europe, the trade alone with Europe.

The CHAIRMAN. You mean merchandise and travel?

Mr. LEDERER. Merchandise alone, excluding military aid.

The CHAIRMAN. But that still does not answer the question, where does the surplus of European claims against American claims come from?

Mr. LEDERER. It comes from the total of what we pay out for trade, for services, for remittances, for capital movements—which exceeds what we get back.

The CHAIRMAN. Yes; but what part of it is changed?

Mr. LEDERER. Oh, what part is changed?

The CHAIRMAN. Yes.

Mr. LEDERER. All parts have changed. The imports from Europe have gone up very substantially.

The CHAIRMAN. But still our exports are at least equal to our imports?

Mr. LEDERER. Yes.

The CHAIRMAN. So that there is no net balance in favor of Europe on those items.

What I am trying to get at is to isolate the items from which Europe has a greater volume of credits against us than we have against them.

You say it is the total, but it is the total minus exchange of merchandise. It must lie somewhere, this residual, and I am trying to locate just where this residual is.

Mr. LEDERER. The residual, if you want to put it that way, is service items and travel, transportation, any number of other things; capital transactions, remittances—all these.

The CHAIRMAN. You do not think the military aid has any part of this?

Mr. LEDERER. The military aid itself does not contribute any dollars to Europe.

The CHAIRMAN. What about the expenditures of military personnel abroad?

Mr. LEDERER. That, yes. That does.

The CHAIRMAN. What about what is termed defense support, where we pay for military supplies produced in the country to which the aid is given?

Mr. LEDERER. That is a very small item at the moment. It ran in 1958 at about $200 or $250 million. That is, the offshore procurement under the military aid program.

The CHAIRMAN. I submit we are in a puzzle here.

Mr. LEDERER. That is included here under military expenditures.

These military expenditures are quite sizable in Europe. The total here is about $3.4 billion in 1958. Europe, out of that amount, gets something like $1.8 billion.

These are cash expenditures, but——

The CHAIRMAN. There are no offsetting items on the other side to balance these?

Mr. LEDERER. No.

The CHAIRMAN. Well, that is about equal to it——

Mr. LEDERER. There is no offsetting item, but this item has not increased materially over the last years. It is not that item where you find the major part of the change. The change was primarily in the increase in imports of other goods and services and a decline in exports.

The CHAIRMAN. This is a rather brutal conclusion, but let me put it very briefly:

You say it is necessary to deal with this problem of increasing claims of foreign countries, particularly Western Europe, against the United States. Would not the most direct way be to shut off military aid, have them bear the costs of their own defense?

Mr. LEDERER. From a purely balance-of-payments point view, if you shut off military aid, that is, the exports of military equipment, then if they do not buy any part of what they lose, you would not get any change in the balance.

The CHAIRMAN. But I mean defense support and costs of military personnel abroad.

Mr. LEDERER. That is a different item here. That means you have to pull back the troops which are there. Most of these expenditures, not all, but most of these expenditures are expenditures by the personnel and for the maintenance of the personnel, like buying foods. Some is construction expenditures on bases, and there are some purchases other than that.

The CHAIRMAN. Thank you very much, Mr. Lederer, and your written statement will be included in the record at this point.

(The statement referred to follows:)

STATEMENT BY WALTHER LEDERER, CHIEF, BALANCE OF PAYMENTS DIVISION, OFFICE OF BUSINESS ECONOMICS, DEPARTMENT OF COMMERCE, ON RECENT TRENDS AND CURRENT PROBLEMS IN THE BALANCE OF INTERNATIONAL PAYMENTS

The Office of Business Economics and its predecessor organizations in the Department of Commerce have since 1922 compiled the U.S. balance of international payments. Prior to World War II these data were published in annual bulletins; since then, they have appeared quarterly in the Survey of Current Business. The current issue of that magazine—for June 1959—contains figures for the first quarter of this year as well as earlier periods.

In the long history of development of this basic analytical material, detailed information on the component accounts has been vastly expanded, since these have independent utility for more specialized analysis. For example, the December 1958 issue of the Survey of Current Business reviewed trends in merchandise trade during the 1957–58 business adjustment; the current issue provides data on travel expenditures by Americans last year; a forthcoming article will bring up to date our information on U.S. private direct investment abroad.

I mention this to suggest that in responding to the committee's request for facts and figures on our international transactions, and for a summary of trends and recent developments, I shall necessarily give a condensed treatment of materials available in extensive form. Further detail on specific points can easily be provided for published sources, and these, of course, also constitute a basis for other analytical findings.

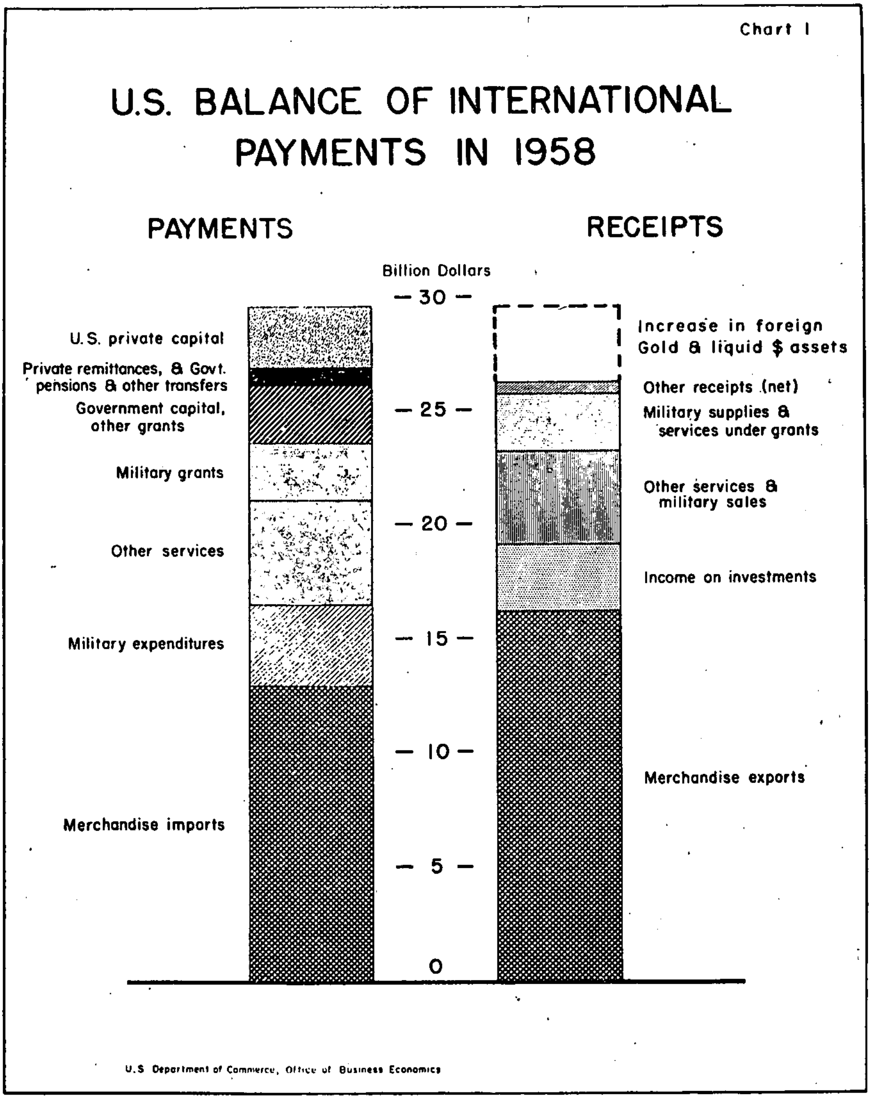


Chart I
U.S. BALANCE OF INTERNATIONAL PAYMENTS IN 1958
PAYMENTS
RECEIPTS
Billion Dollars
30
25
20
15
10
5
0
U.S. private capital
Private remittances, & Govt. pensions & other transfers
Government capital, other grants
Military grants
Other services
Military expenditures
Merchandise imports
Increase in foreign Gold & liquid $ assets
Other receipts (net)
Military supplies & services under grants
Other services & military sales
Income on investments
Merchandise exports
U.S Department of Commerce, Office of Business Economics

In 1958, the excess of our foreign payments over receipts was $3.4 billion, but net payments increased steadily during the year and the data for the first quarter of this year indicate a continuation of that trend.

This figure represents the rise in our short-term liabilities to foreign countries and international institutions and the decline in our monetary gold stock. In the first quarter of this year our monetary gold stock declined by $96 million, and our short-term liabilities increased by about $770 million. During 1958 foreign countries took $2.3 billion, or about two-thirds of their net dollar receipts in gold, and raised their holding of short-term dollar assets by about $1.1 billion.

*Types and size of foreign transactions*

First, with the aid of chart I, I should like to review the various types of foreign transactions and the magnitude of each in 1958. Balance of payments compilations are based on the principle of double entry bookkeeping, so that each transaction appears as a debit and credit entry, although the estimates usually are not made that way. It may be observed at this point that the compilations include not only transactions involving actual payments, but all international transfers of goods, services, or capital assets. When goods or services are transferred to foreign countries without tangible compensation, they are included in exports, and the same amount is entered on the payment side of the balance sheet under gifts or grants. If payment is deferred, the exports are balanced by corresponding capital movements. Thus it may be seen that for many transactions there is a close interrelationship between credits and debits and a change on one side involves often a corresponding change on the other, without effect on the balance.

The total of our payments to foreign countries (as defined here) in 1958 was $27.1 billion excluding, and $29.6 billion including, military grants-in-aid. Of these amounts, $12.9 billion, or less than half, was represented by merchandise imports.

Other purchases were about $8 billion. The largest item in that group—$3.4 billion—was military expenditures abroad. Included in this total are the expenditures of our troops stationed in foreign countries, purchases by the Armed Forces of all kinds of services and commodities (some of which were imported into this country), and construction expenditures. Other types of transactions included in the $8 billion are our foreign travel expenditures, transportation, insurance, and interest and dividends paid on foreign investments here.

The net outflow of private capital from the United States last year was $2.8 billion, including $1.1 billion of direct investments in foreign branches and subsidiaries of our domestic corporations. The remainder consisted mostly of purchases of foreign securities issued in U.S. markets and long- and short-term bank loans.

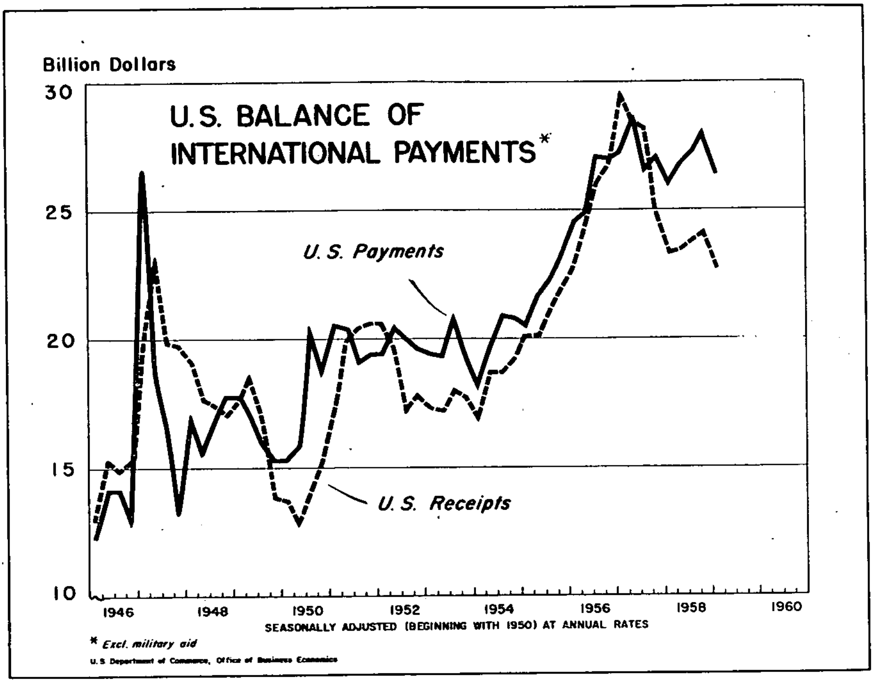
The net outflow of funds through Government nonmilitary grants, loans, and changes in other claims, arising mainly through sales of agricultural products for foreign currencies, was about $2.5 billion. Military grants were of about the same magnitude.

The total amount of Government funds going abroad—including purchases of goods and services in foreign countries by Government agencies and their personnel and disbursements to or on behalf of foreign countries through grants or capital transactions—amounted to about $9 billion, or 30 percent of the total on the payments side of our international transactions. If grants of military supplies and services are excluded the share of Government funds in total payments was about 24 percent. Thus the relative size of Government expenditures in our foreign payments is roughly the same as the share of Government expenditures (including Federal, State, and local) in our domestic economy. In 1957, Government expenditures were about one-fourth of our gross national product.

On the receipt side of our balance of payments merchandise transactions are a greater factor than on the payments side. Including military goods supplied under grant aid programs, merchandise transactions comprise about 72 percent of our total receipts of $25.7 billion, and excluding military grant aid, about 70 percent. Of the remaining receipts the largest item was our income on foreign investments, both private and Government, which in 1958 amounted to about $2.9 billion.

Exports financed by the Government are, of course, included in the total, but with the exception of military supplies and services are not readily identified.

From these data it may seem how the United States can have a rather large excess of exports over imports on merchandise alone, or even on goods and services, and yet have an excess of payments if all transactions, including movements of U.S. capital, Government grants, and private gifts are taken into consideration.




CHANGES SINCE WORLD WAR II

Chart II shows how our balance of international transactions has developed since World War II.

From 1946 to the third quarter of 1949, our receipts from abroad exceeded our foreign payments. This was the period of postwar reconstruction, postponed replacements of capital and durable consumer goods, and rebuilding of depleted inventories. Beginning with the last quarter of 1949, our balance shifted to an excess of payments over receipts. This balance in our foreign transactions has continued since then with two relatively short interruptions.

The first started in the middle of 1951 and lasted for three quarters. It followed the outbreak of the Korean war when foreign expenditures continued to rise while ours were already past their peak. The second temporary reversal in our balance of payments from net payments to net receipts began at the time of the Suez crisis in the late fall of 1956 and lasted about 1 year. During that time foreign demand was increased not only because of the closing of the canal, but more so by inflationary credit expansions in Europe as well as elsewhere, and unfavorable harvests in some of the European countries. As a result of the strong measures applied in the United Kingdom, several other European countries and Japan, the excess demand in their economies was brought under control and their balance of payments improved while ours reverted to the previous pattern of an excess of payments with the fourth quarter of 1957.

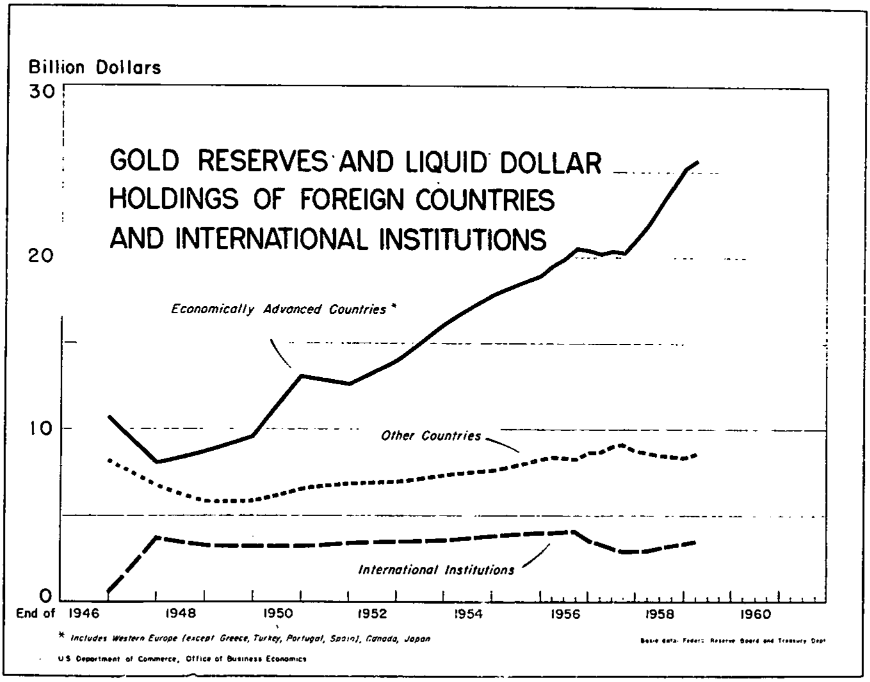
In the course of 1958 our net payments increased, however, and that rise continued through the first quarter of this year. The excess of payments in our foreign transactions in 1958 and so far this year does not represent a sudden shift in our balance of payments, but a return to the balance which we had since the end of 1949.

What did change, however, was the size of the excess of payments. In the year ending with the first quarter of 1959, the excess was about $2 billion higher than in the year ending about the middle of 1953 when net payments were at their previous peak, and only slightly less than the annual rate during the second half of 1950 shortly after the outbreak of the Korean war.

### FAVORABLE EFFECTS OF NET DOLLAR OUTFLOW

During most of the 1950's, the excess in the dollar outflow made it possible for foreign countries to rebuild their gold and dollar reserves, which had been depleted during the war and the first 4 postwar years. In fact, many foreign countries restricted payments to the United States for imports and other purposes, so that they could retain some of the dollars they received. The gradual restoration of foreign reserves made it possible, however, to relinquish the bilateral trading patterns which had to be established after the war, and gradually to restore multilateral trade. Discriminatory restrictions on dollar expenditures were also reduced.

These developments found their most recent expression in the establishment of nonresident convertibility of the British pound and most of the major European currencies, and further removals of discriminatory restrictions on dollar payments by the European countries late last year and in the first 5 months of 1959. The time is too short, however, to evaluate the effects of these recent measures on our balance of payments.




The net transfer of dollars to foreign countries had favorable consequences, therefore, by making it possible to create a unified trading system among the countries in the free world and by preventing the segmentation of these countries into small blocs with detrimental political and economic consequences.

The reasons for the large rise in the imbalance in our foreign transactions since the beginning of 1958 cannot readily be seen from the changes in these transactions themselves. If one starts out with 1957, when we had a temporary excess of receipts, the change appears to have been due to a decline in receipts, mainly from merchandise exports. If one compares the recent payments and receipts with 1955 or 1956, higher payments rather than lower receipts seem to have been responsible. By changing the base period of the comparison, one can come to exactly opposite explanations of the changes which have occurred. Actually, conditions creating a disequilibrium in the balance of payments usually affect many of the major types of transactions on both sides of the balance sheet, including exports, imports, capital movements, and others.

Some explanation of the recent developments may be obtained, however, from the direction of the net flow of gold and dollars. Chart III gives a 3-way break of foreign gold reserves and liquid dollar holdings.

The increase in gold reserves and dollar holdings which resulted from the net payments in our foreign transactions since 1950 accrued primarily to the countries with relatively advanced economies, particularly in Europe, but also Japan and, mostly in the earlier years, Canada. The large dollar outflow in 1958 and 1959 went in the same direction.

To some extent the net flow of dollars to these countries may be attributed to Government operations. While grants and credits to these countries have gradually declined, and—except for military aid and special emergency loans—virtually stopped several years ago, military expenditures increased. Grants and credits were mostly in the form of goods and services, and potentially had less direct effect on the balance of payments than military expenditures which are all in cash. In the last few years, however, military expenditures were comparatively stable. The recent rise in the net flow of gold and dollars was due to changes in commercial transactions, suggesting a change in the economic relationship between these countries and the United States.

This change has not come suddenly but has developed gradually. Of course, this development had to be expected, as these countries reconstructed their economies and later rebuilt their monetary reserves. Through 1956, their productive capacity was well absorbed by the demands created by the growth of their economies, and resources needed to rebuild their reserves were relatively limited. In 1957, their internal demand, in fact, expanded faster than their ability to meet it, with the result that their foreign exchange receipts fell short of expenditures.

In 1958, however, the economic growth in Europe and Japan was interrupted although in Europe as a whole, at least, economic activity did not decline. Thus, industry in these countries had the opportunity to accept a larger share of available orders and expand into new markets, which made its competitive standing relative to our industry more obvious. We find the increased competition in our domestic markets as well as in our sales to these countries and in our business in the less developed areas. These developments increased the net flow of dollars from the United States to these countries both directly and indirectly by way of other countries.

The gold and dollar holdings of most of the less developed countries showed only relatively short-term fluctuations since World War II and over the period as a whole did not rise by major amount. This was not because these countries had sufficient reserves, but because, with few exceptions, the pressures of development programs and internal credit expansions raised their import demand to the limits of their financial resources.

### PRESENT PROSPECTS FOR IMPROVEMENT

Major improvements in our balance of payments can be expected only from changes in our foreign transactions which result—directly or indirectly—in a reduction of the net flow of dollars to the more advanced countries. This can be accomplished both by a reduction in outflow of funds and an increase in the return flow. The latter would, however, be more consistent with expanding world trade and prosperity.

Some decline in the outflow of funds through bank credits occurred recently as a result of the tightening of the domsetic money supply, but it was more than offset by a further drop in exports. Other adjustments can be expected from developments which are already underway or from actions which have been taken.

Relatively high imports and low exports of steel in recent months may be in part due to temporary conditions arising from the high domestic demand for steel in anticipation of a strike this summer. By next fall the balance in steel trade may be more favorable. Cotton shipments were unusually low this crop year as foreign countries reduced their inventories, and replenishments expected by next fall may increase exports. Large orders for commercial airplanes will start to be delivered this fall and an increase may also be expected in paid deliveries of military equipment now on order. Furthermore, the rise in business activity in Europe, Canada, and Japan appears to have been resumed again and this should have a favorable effect on our exports. At the sme time, however, the continued rise in business activity here will stimulate our demand for foreign goods and services, and possibly also our foreign investments.

The net effect of a simultaneous rise in business activity here and in other industrialized countries on our balance of payments would be difficult to estimate. Obviously, if the rise in these countries develops into a condition where credit expansion increases demand beyond their ability to meet it, while our economy remains relatively balanced, the overflow of foreign demand will tend to equalize our foreign transactions, or turn the balance into net receipts. This was the case in 1957. It may not be realistic, however, to expect a repetition of this extreme situation, nor would it be satisfactory to depend for a balance in our foreign transactions upon such extraordinary circumstances.

Although present circumstances are obviously rather different, one may draw to some extent on experiences in previous years to evaluate the balance of payments effect on a simultaneous economic expansion both here and abroad. In general, it appears that during the postwar period the outflow of funds from the United States was relatively less affected by cyclical fluctuations than the inflow.

Changes in foreign business activity appear to have had a larger effect on the balance in our foreign transactions than changes in our business activity. Not only were our imports relatively more stable than our exports, but a decline in imports was in part offset by a lower income on our investments and sometimes also by larger Government assistance to foreign countries and larger private loans. These tendencies made, of course, recessions in the United States much less hazardous to foreign economies than had frequently been anticipated. Our exports, however, seem to fluctuate much more than foreign business activity.

In the near future as business abroad improves, we have to expect that this pattern will continue, with receipts rising faster than expenditures and a consequent decline in the net payments balance.

From the year ending in the middle of 1953 when foreign business just started to come out of a relatively slack period and our net payments balance was at the previous peak—until the year ending with the Suez crisis, and before foreign business had reached boom characteristics—our net payments declined by about $1 billion.

The disappearance of special factors accentuating the excess of payments in recent months, the deliveries on certain major exports now on order, and the effects of the incipient business expansion abroad will reduce the net payments balance in our foreign transactions by a substantial amount.

The current magnitude of this balance and the size of these corrective forces which are now visible suggest, however, we cannot rely on these forces to reduce the net payments down to the level existing during the pre-Suez year, or during the average of the entire 1950–57 period. Additional efforts or measures will be required to bring about further improvements in our balance of payments. The adjustment problem is smaller, however, than the present excess of payments would suggest, and should be well within our capacity to solve.

### THE REMAINING PROBLEMS

Two major problems in the field of our balances of international payments seem to confront us.

First, adjustments are needed so that at periods when the economies here and in other industrial countries are in a comparable phase of the business cycle our payments do not exceed our receipts by more than reasonable additions to foreign reserves and working capital. That will require changes both in our balance of payments and those of other industrial countries.

Even after such adjustment there would remain a somewhat longer range problem related to the size and expansion of foreign reserves. From the beginning of 1950 to the end of 1958, foreign gold reserves and dollar holdings increased from $18.7 billion to $36.9 billion. Of the $18.2 billion increment, $4.7 billion was obtained from new gold production and some sales by the Soviet bloc, and the remainder from the excess of payments over receipts in our balance of payments. During that period we settled these net payments by transferring about $4 billion of gold and $9.5 billion in dollars which foreign countries kept here on deposit or in Government securities.

At the end of 1958 our monetary gold stock was about $20.6 billion and foreign holdings of liquid dollar assets (including Government but not private securities) were about $17.6 billion. About half of the latter amount are dollar reserves of foreign central banks and governments, about $6 billion belonged to foreign banks, corporations, and individuals, and about $1.6 billion to international institutions.

The CHAIRMAN. The discussion will be continued by Prof. Wilson Schmidt of George Washington University.

## STATEMENT OF WILSON E. SCHMIDT, ASSOCIATE PROFESSOR OF ECONOMICS, GEORGE WASHINGTON UNIVERSITY

Mr. SCHMIDT. My statement will run about the allotted time. May I simply read it?

The CHAIRMAN. Yes; you may.

Mr. SCHMIDT. Does the recent hemorrhage in the United States balance of payments portend a dollar glut? And if it does, why concern ourselves with it?

When the United States spends, invests, or gives more dollars abroad than foreigners require to buy our goods, services, and long-term assets, they either use the surplus dollars to buy our gold or hold them in the form of liquid assets, creating short-term liabilities against us.

We obviously cannot rely on gold to balance our accounts forever since we have only a finite supply. And even though that supply seems large at present, we should remember that we have substantial short-term liabilities to foreigners which they can exchange for gold.

In the event of persistent deficits, perhaps we could rely on foreigners to finance our deficits by adding continuously and rapidly to their liquid dollar holdings. But this may be dangerous because, at some point, the continued deterioration which that would imply for our net reserve position (gold less short-terms liabilities to foreigners) might occasion uncertainty, well founded or not, over the stability of our exchange rate, particularly in times of difficulty such as 1958; this might cause foreigners to question the future value of their dollar assets and perhaps induce them to exchange those assets for gold.

A persistent tendency, therefore, for the United States to supply more dollars to foreigners than they require, with or without a flow of gold, may thrust policy changes upon us designed to prevent a drift toward a dollar glut. Some of the techniques selected could reduce our freedom of action in domestic and foreign policy. And if we are complacent in the face of such a prospect, we could eventually be forced into abrupt action which would be unnecessarily costly in terms of employment, output, and the benefits from trade.

Since the end of 1949, foreigners have accumulated an annual average of $1.5 billion of gold and liquid dollar assets from us. Whether this deficit will grow or shrink in the future is exceedingly difficult to predict because forecasts in this area are especially treacherous. One reason for this is that the net balance-of-payments position is the outcome of two large numbers—total receipts and total disbursements. A minor error in forecasting either magnitude can cause an extremely large error—in both size and sign—in the forecast of the difference between them. Rather than attempt a prediction, let me offer some points which suggest that it could be difficult for us to avoid continued deficits without changing public policy. If convincing, they should serve to cause policymakers, at minimum, to scan some unfamiliar numbers in future years—the gold stock, short-term liabilities to foreigners, and the balance-of-payments deficit.

(1) U.S. merchandise imports could accelerate over the long pull. Two close students of international trade, Henry Aubrey and Sir Donald MacDougall, after painstaking analyses, have offered projections which support this. Aubrey thinks that U.S. imports might rise to 3.2–3.5 percent of the GNP when our output is twice its 1950 level. Sir Donald does not consider 3.2 percent to be impossible. With the recent ratio running slightly below 3 percent and remembering that minor changes in large components of the balance of payments cause major shifts in the balance-of-payments deficit, those changes alone would be sufficient to produce a substantial increase in the deficit.

(2) Investment abroad by American business may grow at increased rates. The Common Market is attracting intense interest and may induce heavy U.S. investment in Western Europe. Petroleum investment, which accounts for half the rise in U.S. direct investment since 1950, may come under even stronger stimulus than it has in the past. The Chase Manhattan Bank petroleum experts suggest that worldwide capital expenditures for foreign oil development may rise between 1957 and 1967 to 2.5 times their rate during the previous decade. Similar changes cannot be ruled out for certain other minerals.

(3) The purchase of foreign securities, which has been in the doldrums for much of the postwar period, may accelerate, barring high interest rates here, as U.S. investors gain confidence in and knowledge of the capacity of foreign countries to meet future dollar obligations. This is perhaps part of the explanation for the breakthrough in sales of new issues in the United States in 1958.

(4) An expansion of economic assistance to underdeveloped countries, as is strongly urged in certain quarters, may put heavier pressure on the balance of payments per dollar of aid than the postwar aid programs, at least so far as the direct effect is concerned. The reason is that the percentage of procurement undertaken in the United States has been much smaller for programs in the underdeveloped countries than in the more industrialized areas.

(5) U.S. exports may come under greater competitive pressure than experienced in the postwar period, if for no other reason than the recovery and dynamic growth of Western Europe and Japan. There were signs of this even before 1958 produced the fear that we were being priced out of world markets. The staff of the Economic Commission for Europe writes that—

> Since the large-scale devaluation of Western European currencies in 1949, a process of substitution of Western European exports for those of the United States has been going on and there are as yet no definite signs that it is coming to a close.

The Common Market may add to U.S. export woes. The well-known analysis by Howard Piquet suggests that a third of U.S. exports to the members could be adversely affected. And McGraw-Hill International reports that small U.S. exporters expect to lose 80 percent of their present business, medium-sized exporters 60 percent, and the large corporate exporters about 30 percent. Since the Common Market countries have taken an eighth or more of our merchandise exports since 1953, anything even far short of these shifts could still spell trouble.

(6) The overall trends point to deficits according to some experts. Fortune magazine, with the aid of especially able people, made an item-by-item analysis of what might be expected for the components of the U.S. balance of payments in 1966. They concluded that U.S. expenditures would run about $35 billion and that—

On the basis of current trends (this was before the events of 1958) it is hard to make a case for the proposition that a world with $35 billion to spend in 1966 will rush out and automatically spend in on U.S. goods and services.'

The staff of the Economic Commission for Europe concludes, after careful projections, that, leaving aside military expenditures in Western Europe by the United States—

* * * it seems reasonable to suppose that Western Europe could by the 1970's have achieved balance in its direct transactions with North America on account of goods and services and private capital.

If military expenditures continue at their recent average of $1.8 billion, this would suggest a large direct deficit for the United States. If correct, it is perhaps especially significant because, barring a general loss of confidence in the dollar, it is Western Europe that is most likely to draw on our gold reserves when it enjoys a surplus with us. The reason is that Western Europe includes most of the countries which appear to prefer to hold a major portion of their reserves for the settlement of international payments in the form of gold.

(7) World trade may grow more slowly in the future than it has in the postwar period, as suggested by the staff of the International Monetary Fund. If this is the case, the need for dollar balances to carry on international transactions may also grow at a slower pace. This makes it less likely that foreigners will finance any given U.S. deficit by accepting dollar balances and more likely that gold will flow.

(8) It is hard to see how confidence in the dollar could become any stronger than it was for most of the postwar period, and it could become weaker, causing foreigners to convert their dollar assets into gold out of fear for the value of the dollar. There is little that can be said in this respect that does not fall in the class of a "hunch." The record of 1958, when foreigners added over $1 billion to their liquid dollar assets, indicates that confidence was not lost, though this is subject to doubt in at least two countries. But that may not prove much about the future.

If the United States runs a deficit of $3 billion in 1959, our gold stock will exceed our short-term liabilities to foreigners by only a small margin. And the gold stock may fall below $20 billion. In some quarters, even these levels are thought to be confidence thresholds. I do not know whether they are or not. But we cannot expect to undergo a sustained deterioration in our net reserve position without creating doubts about the stability of the dollar, especially in periods of difficulty such as 1958.

And we should note that sterling may become an increasingly competitive currency for reserve. This is particularly the case, as Professor Triffen reminds us, because, under the European monetary agreement, sterling held by members enjoys a firm exchange guarantee in terms of the dollar, but the dollar enjoys no such guarantee in terms of sterling. As Triffen suggests—

> * * * European central banks are now free to accumulate sterling, if they so choose, without taking any exchange risk in the case of a devaluation of the sterling with respect to the dollar. A substantial lowering of interest rates in New York compared to London might thus easily induce considerable shifts of short-term balances from dollar to sterling assets.

For each of the foregoing points there is a counterargument; and for each counterargument there is a rejoinder. But if the main thrust of this analysis is correct, we could face some unfamiliar choices of policy in the future. The abnormal state of the last 25 years in which we could fashion our domestic and foreign policy in complete disregard of our balance of payments will have passed.

The CHAIRMAN. Senator Javits, do you have some questions to ask this witness?

Senator JAVITS. Yes, I would like to ask Professor Schmidt some questions.

You say:

> If the United States runs a deficit of $3 billion,

and so on,

> we cannot expect to undergo a sustained deterioration in our net reserve position without creating doubts about the stability of the dollar. * * *

Is it your position, therefore, that the size of the gold stock determines the stability of the American dollar?

Mr. SCHMIDT. At least in part, Senator.

Senator JAVITS. Well, is it a major or minor factor? What is it?

Mr. SCHMIDT. I think it is a very difficult question to answer, because we know little about it, it seems to me—what determines this thing called confidence.

Senator JAVITS. I think, however, it is still tied in in an important way to gold.

Mr. SCHMIDT. Yes.

Senator JAVITS. Let us take the Germans in their pre-World War II days. Apparently, they got along on the theory that gold did not matter any more. Did they not?

Mr. SCHMIDT. In essence, yes.

Senator JAVITS. They did pretty well?

Mr. SCHMIDT. Right.

Senator JAVITS. We do not know the size of the Russian gold stock, do we?

Mr. SCHMIDT. No.

Senator JAVITS. Yet Russian credit seems to be pretty good for merchandise in many countries of the world. Is that not so? They have been pretty good pay and they are considered a pretty good credit risk?

Mr. SCHMIDT. They still owe us some money, I believe, Senator.

Senator JAVITS. I am not talking about our intergovernmental problems, but I mean commercial transactions.

Mr. SCHMIDT. Yes, sir.

Senator JAVITS. In other words, if gold were not nearly the determining factor that your paper considers it to be—and that is pretty much old line economics. It may still be very valid, but it is pretty much old line economics—what would be the other factors that we should worry about? In other words, if the gold outflow itself is not a mater of the greatest moment any more, is there any other disquieting aspect to the situation of which we should be taking account?

The point of my question is this: Suppose we took precautions against a gold outflow and it turned out to be all wet; people are not really worried about gold, they are worried about something else. Is there anything else in our situation in this imbalance of international payments that should worry us?

Mr. SCHMIDT. The accumulation of short-term liabilities to foreigners is the second thing.

Senator JAVITS. And you consider that, that is in any way in a questionable zone in terms of the economic position of the United States?

Mr. SCHMIDT. I think it could become so, sir.

Senator JAVITS. Do you attribute that to any particular type of credit which we are undertaking? Is it attributable to private capital investment, or where do you place the reason for this increase in the short-term adverse balance in terms of the debts we owe?

Mr. SCHMIDT. A dollar is a dollar is a dollar is a dollar.

Senator JAVITS. In other words, no matter how it goes out it is the aggregate of the position that counts?

Mr. SCHMIDT. That is right.

Senator JAVITS. I noticed also that implicit in your paper is the theory that all of this goes out and that the only thing that comes back is the ascertainable factors which are set forth in this chart. What the proposition that if we have more U.S. private capital investment, we are bound to have more U.S. income on investment in underdeveloped countries, or the rate of return is apt to be very much larger.

Mr. SCHMIDT. This is certainly an optimistic factor, one of the major ones. However, if private investment accelerates quite rapidly the subsequent gain in earnings affords little immediate aid because there is a 3- or 4- or 5-year lag——

Senator JAVITS. Do you consider that we are in such jeopardy that we should now cut down on the private capital investment or other outflows of our dollars?

Mr. SCHMIDT. It is my general position that no direct action should be taken on any item in the balance of payments in order to balance our accounts.

Senator JAVITS. That is exactly what I wanted to get. In other words, you are not recommending action to us now. Then, what is the point of this analysis? What do we do about what you are telling us?

Mr. SCHMIDT. Apparently, I did not make my last statement clear: No direct action on any particular item in the balanced payments, should have been my emphasis. Perhaps I should explain.

I do not believe that we should intervene in the marketplace or change appropriate governmental expenditures in order to balance the accounts. I think we should try to adjust the total economy, if you will, to balance our accounts if we find that is necessary.

In your particular question, I do not at the moment think that we have to take any action. I would prefer to see us let it ride and watch what happens. I do not think there is enough evidence yet that we are in trouble. But at the same time, I think this bears exceedingly close watching by people on your staff, who will warn when the situation may be getting serious.

I am afraid that we will never know exactly when it gets serious, because we do not know enough about these speculative or confidence factors.

Senator JAVITS. In other words, you have no specific recommendations for cutting down any of these expenditures or for increasing any of these receipts, because you feel no matter what we do would be interfering with the market. All you counsel is that the situation is not yet at the point where we ought to take action, but that we watch it until it gets to that point, if it does.

Mr. SCHMIDT. Right.

Senator JAVITS. What would you consider such a point to be?

Mr. SCHMIDT. I must confess I do not know.

The CHAIRMAN. Congressman Coffin.

Representative COFFIN. I just want to ask one question.

In your statement you say that a number of people think that $20 billion is the magic figure.

In the light of the history of our accumulation, we have not had $20 billion for too long a time. Before World War II, it rose from $4 million or $8 million to $26 billion in a very short period of time. So in the light of that, why do these people feel that $20 billion is a threshold?

Mr. SCHMIDT. Mr. Coffin, I have great difficulty explaining why people think that some point is a point of difficulty. I simply report this as a statement that has been made in the London market. Frankly, I do not think it has much basis; but if enough people believe it then it has some basis.

Senator JAVITS. Would the Congressman yield to me for one little question?

Hypothetically, suppose that we ran a surplus of governmental intake over governmental expenditure this year and next year, and we lose half our gold stock; we decided to give it away, lend it away, give it to a bank that would stabilize world currency. Do you think our position would be stronger or weaker?

Mr. SCHMIDT. It depends on what kind of additional action you were willing to take. The gold loss is of no significance, Senator Javits, if you are willing to take appropriate action in the exchange rate field. In fact it may be a very good thing.

Senator JAVITS. In other words, you are not yourself a slave to the theory of a certain cover of gold currency?

Mr. SCHMIDT. Certainly not.

Senator JAVITS. Thank you, Mr. Chairman.

The CHAIRMAN. Professor Kindleberger.

## STATEMENT OF CHARLES P. KINDLEBERGER, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. KINDLEBERGER. Thank you, sir.

I propose to summarize my statement in a few words.

The CHAIRMAN. I will say I have read your paper, which I think is extremely good, and if you would like a little bit more time than the 10 minutes assigned, I think it would be acceptable.

Mr. KINDLEBERGER. The paper runs well beyond 10 minutes, so let me summarize it rather than trying to read it.

The CHAIRMAN. Very well.

Mr. KINDLEBERGER. The figures which Mr. Lederer has given seem to me to be very useful in setting a background. In the last few months we have had a few papers presented to the profession trying to explain these developments. They offer rather different views. One is the view of Professor Hinshaw at Oberlin College, who suggests that the trouble all began back in 1950. The accumulation of gold and dollars has been piling up year after year since 1950; in this view no new change has taken place at all. In fact Professor Hinshaw, who is a devotee of the view that small price and exchange rate adjustments are very effective in bringing about changes in balance of payments, would assert that the devaluation of sterling in 1949 converted the surplus in U.S. payments to a deficit.

The other paper to which I refer is by E. M. Bernstein, in which he suggests that the present deficit has nothing to do with the current account in the balance of payments at all, that is, nothing to do with exports or imports. The whole nub of the issue lies in military aid and other aid, and that we are just giving too much aid, and this is the reason we are losing gold and dollars.

These are both eminent men in the field, and I hesitate to differ with them, but I think that both are wrong, sir.

Mr. Bernstein in particular seems to me to fail to indicate that much of the foreign aid that goes abroad is in fact tied to exports. The military aid which goes abroad in the form of military supplies is clearly tied to exports, and he makes, to my mind, a very serious mistake when he talks about our aid to Europe including this.

It is true, as Mr. Lederer has suggested, that if we were to stop this aid and our allies were to buy the same goods here, we would get a gain in dollars. It is also true that if they were to produce the goods there, they would have less resources available to produce exports, and they might have a little more inflation and buy some more imports. This is the way the balance of payments presumably adjusts.

But I think it is a mistake to say this is adding to our deficit. I agree with Mr. Lederer in thinking that this is a mistake.

The view I would assert is that there has been a fairly fundamental change in the position of the United States, vis-a-vis the developed areas. While this has been continuous, as Mr. Lederer's chart suggests, it has come more and more into focus since about 1954.

The recession of 1954 is an important turning point for direct investment. A number of companies went abroad that year for the first time. The direct investment figures picked up very rapidly in 1956, when they really got going. But plans were made in 1954 during that recession.

What I have suggested in my paper is that the horizon of American business has been lifted from the national scene to an international one.

Consumers have looked abroad for more products. They have been less concerned as to whether a product is imported or not, and more interested in getting the cheapest product, wherever it is from. I agree to an extent with Hinshaw in this respect. But I am also impressed by the fact that the technological gap which we had over Europe, which explained a good deal of our earlier success in exporting, a gap which a man like Crowther used to explain the dollar shortage, seems to have petered out.

The importance of technological progress is clear in chemicals. During this period when exports as a whole are dropping, chemical exports to Europe have been expanding. In plain old-line chemicals exported to Latin America we are not doing so well, but in the European market U.S. exports are rising impressively, based on continuous technological improvement. And more and more it seems to me our innovations are being copied very rapidly by foreign countries, such as the transistor radio by the Japanese, the hi-fi equipment by Germany, and so on, while their innovations are increasing. I cite the small automobile in this paper. We seem to move very slowly to imitate their product and to plunge into the market.

It was thought by many people that once the big American companies had made up their minds to produce small automobiles, they would wipe European small automobile imports off the map in no time at all. But I have not seen this, and experts do not now think that it looks likely.

In other words, the fundamental alteration in our position is due not to simple inflation as the man in the street thinks, nor to simple price adjustment, nor to foreign aid, but to a combination of factors as a result of which the United States has now become in many respects one of a number of countries instead of a leading country in every respect. We are no longer unique in the trading world. We no longer can say, "Foreign countries need to buy our goods, but we don't need to buy theirs." Trade is now becoming much more balanced.

This is good. This represents the achievement of the goal toward which we have been heading. This is what our policies were directed to achieve, and it is in general a desirable outcome.

But it means, I think, as Professor Schmidt says, that we can no longer ignore the international aspects of our domestic policies, as we have been able to.

I want to support Mr. Lederer's remarks about the temporary character of some of the surplus of 1958 and 1959. One activity that revived in 1958 was the issue of bonds by foreigners in this market. This has been cut off this year as interest rates have tightened.

Another outflow that picked up this year has taken the form of the purchase of foreign equity securities by Americans. This again involves a lifting of the American horizon to the world market. Imvestment blue chips now include European blue chips, and people are prepared to acquire them when U.S. stock market prices get very high.

But there are other things that we do not yet have a quantitative feeling for. One is the increase in imports of steel that have taken place due to the inventory accumulation against the strike which is a strong possibility shortly. Idle steel capacity was available in Europe. Imports for the first quarter are extremely high from Belgium, from Germany, from France, and Italy, which have steel capacity, a big leap over last year. In addition our exports of steel have dropped sharply, which means that customers in underdeveloped areas have been unable to get their supplies from this market. We cannot tell yet how much of this change is short run.

I would list the other things which Mr. Lederer says, like the decline in cotton exports which is clearly short run, but I do want to add the possibility that the swing in steel net sales is a short-run factor too.

Much of this is self-correcting. You have full employment in Europe, and not full employment here. The British figures on employment were released today, and they show the biggest drop in unemployment for May to June in any recent year. Labor is tight, and there are strikes going on, the printing strike in London and the steel strike in Italy. Europe is going to have wages rise higher. We can expect more of the big gain of productivity in Europe to go into wages. Little of it has gone into wages in the last few years, comparatively. A change in this respect will raise consumption and help to bring about the balance.

But it follows with the United States becoming not the leading country in every respect, that we can redistribute the burden of foreign aid. It is not foreign aid to Europe I am speaking of; but foreign aid to all parts of the world.

I do not think that military expenditure by U.S. troops in Europe is foreign aid. One could debate this, whether the troop pay expenditures by U.S. troops should be paid for by the United States or by the foreign country. It is a debatable point, but there is a long tradition that except for defeated countries, each country pays for expenditures abroad by its own troops.

With Germany, you remember, we levied the cost of troop pay on the defeated country, but U.S. experience in Britain and British experience in allied countries was always that each country provided its own troop pay.

While this is a debatable issue, I think the precedents are against us.

The CHAIRMAN. The precedents are against what?

Mr. KINDLEBERGER. The precedents are against any attempt to shift troop pay from American appropriations to European appropriations.

But much more important, I think, is to debate the question of whether they should not share with us on a somewhat different basis some of the general expenses for aid to underdeveloped areas. They show an interest in doing this and I would encourage this interest. I am not trying to cut foreign aid; it should be what it should be, for political and other purposes. Let's have foreign aid where we need to have it and then try to find an appropriate sharing basis which has some relation among other things to the balance of payments.

I think that is about what I would want to say, sir. There are a few other points in my paper.

The CHAIRMAN. Thank you very much. Your paper as a whole will be printed.

(The statement referred to follows:)

STATEMENT OF CHARLES P. KINDLEBERGER, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

My name is Charles P. Kindleberger, and I teach international economics at the Massachusetts Institute of Technology.

I wish to comment at some length on the recent outflow of gold from the United States and its implications for U.S. domestic economic policy and overall foreign policy.

Three months ago the American press woke up with a start to the loss of gold through the balance of international payments in 1958 and the first quarter of 1959 and jumped to the conclusion that inflation in this country had outstripped that in the rest of the world with the result that we were "pricing ourselves out of world markets." Today, happily, there is a much better understanding of the real position. It is recognized that overall prices have risen in the United States just about as much as in European countries and that wage rates have risen, on the whole, a smaller percentage here than there. It is true that the absolute rise in money wages in this country has been higher than in Europe—a 20-percent rise in U.S. hourly earnings since 1953 is larger than a 40-percent increase in German wages, when the 1953 rates were $2 an hour in this country and 50 cents in Germany. Moreover, though there is difficulty in getting exactly comparable series, there are indications that steel prices in this country have risen more than those abroad, particularly more than Japanese, probably more than British, and possibly more than German and Belgian. On the whole, however, the view that the U.S. balance of payments has turned adverse because of inflation is widely recognized as largely wrong and entirely oversimplified.

Let me first review what has happened to our balance of payments, list some of the lesser causes which have contributed to this result, and finally, before going on to discuss their implications for policy, pinpoint the main underlying changes in the position.

The gold outflows of 1958 and the spring of 1959 come on top of a substantial acquisition by foreigners of balances in the United States which goes back, with interruptions on such occasions as Suez, all the way to 1950. It is inaccurate to say that change in one item in the balance of payments has brought about the change in another: all the items are interdependent and mutually determine one another. But loosely speaking, one can say that the foreign acquisition of approximately $12 billion which has brought our present short-term liabilities to foreigners to $16.6 billions has been the result of governmental grants and private investment abroad substantially in excess of our net export surplus of goods and services. For the 9 years from 1950 to 1958, inclusive, and excluding military supplies and services transferred abroad under grants, the annual average export surplus of goods and services has amounted to $2.7 billion, against which there have been unilateral transfers, largely governmental grants other than military, of $2.7 billion, a private capital outflow of $1.8 billion and a governmental capital outflow of $0.4 billion. The result has been, ignoring errors in estimating, that foreigners have added to their gold at the rate of $400 million and to their balances at $1.3 billion annually.

Changes have occurred in the proportions in which foreigners have acquired dollar balances and gold, and 1958 marked a substantial increase in the outflow of gold, which amounted to $2.3 billion for the year. But this did not reflect any loss of confidence in the dollar by foreigners, whether foreign governmental authorities or speculators in foreign banking centers. Short-term interest rates were low in 1958 and working balances high. In consequence, new claims on the dollar were converted into gold. But foreign balances were not drawn down: U.S. liabilities to foreigners in fact rose by $1 billion during the year. And as short-term money rates tightened in 1959, these deposits continue to build up at a faster rate.

While the United States has been losing gold and dollars then for 9½ years, it is important to observe that between 1957 and 1958 there has been a sharp change. Foreigners lost net gold and dollars by $200 million in 1957 and gained $3.4 billion in 1958. The heavy losses by the United States in 1958 have continued into 1959 as exports declined during the first quarter from the 1958 level and imports rose even more. Underlying these short-run changes, and hidden by the average figures cited, have been a steady rise in U.S. military expenditure abroad, a sharp upward movement of U.S. private investment since 1955, and an increased outflow of governmental capital.

Some of the short-run changes exaggerate the position. In the first place, the 1957 exports were inordinately large as a result of the export of substantial quantities of oil to Europe at high prices because of Suez.

Another important influence of the last few months, but one which cannot be measured accurately, is the accumulation of steel inventories against the possibility of a steel strike beginning tomorrow. European producers state that orders from the United States have tripled currently over normal levels. Some of these purchases intended for inventory have in fact been consumed with the upturn of business this spring, but some of the imports of the last few months are borrowed from the future. In 1936 and 1949 inventory accumulation raised the levels of imports above those that could be sustained and narrowed the current-account surplus below its long-term level. That uncertain proportion of present imports which represents accretions to inventories may be regarded as exchanged for gold. It is a common phenomenon in European economies that foreign-exchange reserves fluctuate inversely with inventories of internationally traded goods. That steel has become an internationally traded commodity between Europe and the United States is ascribable to the fact that commodity prices have risen much more than ocean freight rates since 1939. This has expanded the international markets for many bulky products—oil, coal, and steel. This trend, and the reduction in tariffs to which it is similar, have exposed U.S. prices to international competition on a wider front.

A further small transitory influence has been the slight lag of recovery in Europe behind that in the United States. The European recession did not go so deep as did ours, but the low in October 1958 came after that in this country, which was in April 1958. By the first quarter of 1959 the momentum of upturn was higher in the United States than in Europe, and this, even apart from steel inventories, meant that our imports expanded faster than European. As recovery levels off in the United States and continues upward in Europe, this effect will reverse itself. The European recession was particularly serious for coal exports, though these may not recover to previous levels because of the continued inroads in Europe of oil and natural gas. This recession may also be part of the explanation of the decline in sales of cotton by the United States. These fell in the first 3 months of 1959 $125 million below the level of 1958 and accounted for three-eighths of the total loss of exports.

A small part of the U.S. loss of gold and dollars since 1950 is ascribable to the difficulties faced by Germany in regulating its balance of payments, difficulties of an opposite sort to those this country is now experiencing. The German export surplus has continuously been in excess of any amount of long-term lending or investment which the German economy has been willing to undertake, with the result that Germany piles up gold and dollars. Ad hoc measures of lending to the International Bank for Reconstruction and Development and governmental financing of long-term exports have been used, but the problem, similar to that which this country experienced before 1950, persists. A change in the German international position is expected as the country takes a larger share in European defense, but up to now taxation for defense has outstripped expenditures and accumulated treasury surpluses have been the domestic counterpart of the gain of foreign-exchange reserves.

A final small contributing force has been the recent increase in interest on the part of American investors in foreign securities. The present height of the New York stock market has reduced bond yields and the prospect for growth of American equities below the level of many European and even Japanese securities, despite the difficulties of dealing in the latter. This movement, which is one aspect of the greater awareness of foreign opportunities of which I shall speak presently, has been partly offset by the decline in the U.S. bond market in recent months, cutting off what appeared in 1958 to be a revival of interest in foreign sale of dollar bonds in this market. Compared to foreign transactions in U.S. securities, which have been substantial since the 1920's, U.S. investor interest in foreign securities is limited. But it has been growing.

The reversal of the Suez burst of exports, the accumulation of steel inventories, the German balance of payments surplus and the new interest in Royal Dutch, Lever Bros., KLM, and Phillips on the part of American investors are of small moment compared to two basic changes in the American position since about 1953. These are the widening of the horizon of U.S. producers and consumers to the world scene and the narrowing of the technological gap between the United States and the rest of the world. These factors are related. But the increased awareness of foreign opportunities has expanded U.S. investment abroad and imports, while the technological gain in European and Japanese capacity has worked in this same direction, further cutting down U.S. exports in these and third markets.

This country has always had an interest in selling in foreign markets. Since the war, however, more and more companies and consumers have become aware, in many cases for the first time, of the opportunities that exist to buy abroad or to acquire production there. Depletion of minerals and timber turned consumers of raw materials abroad in increasing number, and in particular oil and steel companies. But more and more manufacturing companies which had previously thought of themselves as limited to this country, except perhaps for sales, have begun to scan a wider area. A typical example would be the motion picture industry which got into foreign production largely in an effort to use up blocked exchange. It found that for many purposes foreign locations were cheaper than Hollywood, and that United States and foreign audiences liked foreign locales. A business-machine manufacturer going abroad to escape a foreign tariff found that foreign plants could outproduce those in the United States and supplied this market from abroad. Truly international companies domiciled in the United States began to contemplate where, in the whole world, this or that transportable component could be most cheaply made.

The increase in consumer interest in foreign goods is a familiar story, best illustrated by the success of the sports car and small automobile. It is sometimes suggested that foreign goods have a snob appeal, as if this made them less worthy than American merchandise. This comes with ill grace from industry geared through advertising to cultivate associations between particular products and particular images, whether of aristocratic or sturdy commoner variety.

The widening of the American consumer and business horizon to a world view is expanding direct foreign investment on the one hand, and changing the relationship between national income and imports on the other. Direct foreign investment is being undertaken by an increasing number of companies, partly as a response to particular developments, such as the European Common Market, now underway, but partly simply as a reaction to profitable business opportunities wherever they take place. Manufacturing abroad will increasingly substitute for exports, and may give rise, along with foreign mining and drilling, to increased imports. Earnings on foreign investment will partly displace lost exports and offset increased imports. Since trade figures are published monthly on a fairly up-to-date basis, while figures for earnings on foreign investments are estimated only quarterly and with a long delay, there is the possibility that the public will pay undue attention to the changes in merchandise trade to the neglect of the partially offsetting gains in foreign earnings.

Economists have long been predicting an increase in the percentage of national income spent on imports from the 3½ percent figure to which it had fallen in the early 1950's from 7 percent at the end of the last century. The expected force was the increased need to go abroad for raw materials. But if the American consumer becomes more cosmopolitan, and more interested in foreign goods, whether cheaper or different, this increase in the propensity to import may work out in considerable degree through manufactures.

The closing of the technological gap between the rest of the world and the United States also produces a fundamental change. For the last 80 years much of the buoyancy in American exports was due to technological innovations whether in farm machinery and electrical equipment in the first decade of the century, automobiles and radio in the 1920's, high-speed printing and construction machinery in the 1930's and 1940's, or chemical specialties, pharmaceuticals, and air-conditioning equipment, currently. Inventions occurred everywhere but many of them, like radio and automobiles, were brought to quantity production first in this country. Foreign consumers bought them eagerly, and were prepared to spend in excess of their income. A considerable part of the so-called dollar shortage seems to have been due to continuous innovation on the part of American industry. As foreign countries learned to imitate one product, a new technological gap was opened up in another.

This technological gap is no longer so one-sidedly in favor of the United States. It continues in some fields—chemical specialties as just mentioned, certain branches of electronic and computation machinery. But in other fields, it has been closed or even opened up in reverse. In heavy electrical equipment, airplane engines, automobile design, European innovation proceeds faster than American, and U.S. producers seem ponderous—slow to make decisions, and far from daring—in their attempts at imitation. Japanese imitation of the transistor radio, on the other hand, was of lightning speed.

These two factors—the widening of the U.S. consumer and producer horizon to the world level, and the closing of the technological gap between the United States and foreign producers—portend a fundamental change in the long-term balance of payments position of the United States, on top of the short-run factors which have made for the recent loss of gold and dollars to foreigners. Let me now consider their implications for U.S. policies, domestic and foreign.

In the first place, it is important to emphasize that much of what has taken place so far is highly satisfactory. The superficial redistribution of world gold and dollar reserves places the international financial and trading position in much better balance; and the underlying changes in world reconstruction, U.S. interest in foreign production, and sharing of technological leadership in Europe make it less likely that serious imbalances will occur vis-a-vis Europe and Japan. (The position is not so satisfactory with regard to the producers of primary products.) The initial gloomy forebodings about the dollar and the speculative attacks on it from Zurich, Frankfurt, and Hamburg, have given way to a realistic appraisal of the position in most quarters. A mild readjustment is required in the position of the dollar, and the United States can no longer order its policies in complete disregard of their effects on its international economic position. But while the readjustment needed is in process, it is important not to push the panic button, or to alter fundamental policies in the U.S. interest. In particular, negatively:

There is no need to contemplate devaluation of the dollar, or, along with other countries, an increase in the price of gold;

The position is not so serious that the United States should alter its position on foreign aid, beyond attempting to redistribute a part of the burden to Europe and Japan;

While it is important to restrain inflation for its own sake and for the balance of payments position, there is no need to adopt strongly deflationary policies which would inhibit economic expansion or create unemployment.

Much of the present weakness of the dollar is self-correcting. Insofar as imports represent inventory accumulations, they are borrowed from the future and will decline. Balance-of-payments buoyancy in Europe is leading to continued relaxation of import restrictions against U.S. manufactures. Continued recovery in Europe will lift U.S. exports and limit the supplies of goods available for sale here. Moreover, on a longer run basis, the "natural" remedy of higher wages and costs in Europe can be relied upon to work in the right direction. American investors attempting to construct facilities in Europe are finding it difficult to obtain labor in the best locations in the Low Countries, France, and Britain. Employment is full, and expansion can only come about with higher wages designed to move workers from say southern France to Paris (where housing is lacking), or from the textile regions of western Belgium to the favored locations between Brussels and Antwerp. In the last several years much of the increase in income from increased technological efficiency, on the Continent, has gone into further investment. But tight employment conditions, except perhaps in Italy, seem likely to correct this in favor of consumption.

Another change which will automatically redress the position is the higher interest rates. These have already cut down the floating of new bonds for foreign account, and renewed foreign interest in New York balances. Tight money may also cut down the availability of funds for foreign direct investment, and make the remission of foreign earnings home as dividends more attractive.

There is very little danger from a withdrawal of foreign funds in the United States. It makes no sense to net the $16 billion of foreign funds in this country against the $20 billion gold stock. No other country calculates its reserves net of liabilities, rather than gross, nor does any bank. There is no problem if private owners of funds wish to withdraw them. These have $8 billion, and even if the present rate of loss were to continue for 3 or more years, as I do not think it will, this drain could be met. Foreign central banks which own balances in this country are presumably immune from panic. They have a responsibility to world financial stability as well as to their national interest, and they can hardly fail to bear in mind the action taken by the United States in such measures as the Marshall plan to the ends of international reconstruction and stability. Nevertheless, the Netherlands Bank lost heavily in the devaluation of sterling in 1931; and there were other central banks which speculated against gold in the "gold scare" of April 1937. No public discussions should take place on these issues, but I assume that the Federal Reserve System has reassured itself of the steadiness of its central-bank depositors. It is entirely appropriate for them to convert further additions of reserves into gold, but it would seem undesirable for them to go far suddenly to convert existing balances. To limit their risk, I would think it appropriate for the Treasury to issue them informally exchange guarantees against any loss from devaluation. These would ultimately have to be made good by congressional action, which could not be guaranteed in advance and should not be the subject of a long debate now.

Over the longer run, the distribution of the burdens of the leadership between the United States and the rest of the free world may have to shift. European countries are beginning to talk about embarking on programs of aid to underdeveloped countries. So long as U.S. aid and investment substantially exceed the current-account surplus of this country, and the current-account surplus of European countries is larger than their investment and aid, there is a case for shifting the present distribution of aid before undertaking any enlargement of it. The same holds true in the military field, both in NATO and in non-European parts of the world where this country has been bearing a disproportionate share of defense costs. It is beginning to be time to reverse the movement of piling financial responsibility for the foreign policies of the free world largely on the United States.

The United States must continue to exercise leadership in foreign affairs. I am not urging a withdrawal to isolationism, nor an attack on foreign aid. Moreover we can adopt any level of foreign aid we need for the sake of foreign policy, so long as we recognize the implications of such a level for taxes or other expenditure. It is not true that foreign aid, or any other policy, will make this country bankrupt. A narrower international margin means only that we can no longer will the ends and pay for them out of our reserves. If we will the ends, we must likewise will the means.

There is an important implication of our new international position for wages and price policy. Competition in transport and a low tariff policy imply that there are limits to which a particular industry can raise wages and prices. In steel, this limit has pretty well been reached under conditions where Europe has excess capacity. But this does not lead to the conclusion that wages cannot go higher. The implication is that wages must be geared to productivity, and to wages and production in other countries. In the matter of productivity, management has a responsibility for maintaining investment in cost-reducing equipment, and innovation in new products. I hesitate to speak to the complex steel situation because of lack of information. But generally speaking, it seems inappropriate for management to blame imports on wages, or labor to ascribe them to administered pricing or a loss of innovational leadership. Either or both may be true, but to focus attention on the "blame" for imports is likely to lead quickly to the remedy of higher tariffs or quotas. The appropriate answer is rather more productivity, including new cost reductions and new useful products.

It is impossible then to ignore the international implications of U.S. domestic economic policy, and there are a few steps which we ought to take in the more equitable sharing with Europe of the burdens of military defense and aid for economic development. There is no hurry to take action along these lines, but a prudent administration would not put them off. At the same time, the international position of the United States is no excuse for failing to take any action which is important in its own right—action to correct internal inequities, to insure growth or limit unemployment. It means rather that in taking such action we must now for the first time bear in mind the position abroad, and possibly, where this sets limits to unilateral, one-sided action, we must take complementary steps to protect the balance of payments at the same time that we carry out those things needed to preserve this country as a vigorous and growing nation.

The CHAIRMAN. I am going to ask the staff to get reprints of the articles by Mr. Hinshaw and Mr. Bernstein which have been referred to and have them inserted in the record.

Mr. KINDLEBERGER. I think it would be very helpful, sir.

(The reprints referred to follow:)

IMPLICATIONS OF THE SHIFT IN THE U.S. BALANCE OF PAYMENTS

(By Randall Hinshaw, Oberlin College)

When I was asked to prepare a paper for the present program, my mind went back to a session of the annual meetings of the American Economic Association in January 1946, just a few months after the end of World War II. It was at about this time that one could detect the first faint rumblings of the cold war, but it was too early for the papers at that session to have been prepared with much consciousness of a future problem of coexistence. In any event, mine was not. Nevertheless, the speakers on that program, without claiming any special powers of clairvoyance, were very much aware of the possibility of a future problem of international disequilibrium. Yet they would have been surprised, I suspect, at the form the problem has taken in most of the postwar years.

I

If we take a broad look at the postwar U.S. balance of payments, surely the most striking fact that stands out is that the United States has been in overall deficit with foreign countries since 1949. That is to say, if we exclude the balance with international institutions, the United States has experienced a net loss of gold and dollars to the rest of the world in every calendar year of the fifties. For the 8½ year period from January 1, 1950, to June 30, 1958, this "cash deficit" aggregated $12.3 billion, of which $4.0 billion was financed by gold and $8.3 billion, or more than two-thirds, by an increase in short-term dollar liabilities to foreign countries. Moreover, the deficit was at a near-record annual rate of $3.4 billion in the first half of 1958. Actually, the data show a slight deficit for the year 1949 itself, but the figure is so small that 1949 may best be regarded as a year of balance separating a period of heavy overall surplus from the subsequent period of persistent and frequently heavy overall deficit. This situation of deficit is in marked contrast, not only to the early postwar years, but to most of the interwar period. Indeed, from 1930 through 1941, the U.S. balance of payments was characterized by an overall surplus in every single year.

If we look for an explanation for this striking reversal in the U.S. balance of payments since 1949, we find that some of the more obvious avenues of inquiry turn out to be blind alleys. For example, little light is shed by trying to explain the reversal in terms of the persistently high level of "extraordinary" U.S. Government expenditures abroad. In the first place, the level of such expenditures (grants, net Government loans, and U.S. military expenditures abroad) has been somewhat lower in the years since 1949 than in the early postwar years, averaging $4.7 billion annually for the period 1950 through 1957, as compared with $5.3 billion for the period 1946 through 1949.[1]

In the second place, if the analysis is to get below the surface, it is necessary to distinguish sharply between expenditures which were motivated by balance-of-payments factors and expenditures which were motivated by other considerations. In the early postwar years—say through mid-1950—U.S. extraordinary expenditures abroad were primarily in response to a temporary situation of acute international disequilibrium focused on the United States. The counterpart of these expenditures was the large foreign (particularly Western European) dollar deficit on current account that prevailed during this period. To a large extent, of course, this foreign deficit was a planned deficit, reflecting a remarkable joint undertaking in economic reconstruction.

Since 1930, however, and particularly since 1952, American extraordinary expenditures abroad have not been mainly motivated by considerations of international disequilibrium. Following the outbreak of the Korean war in mid-1950, the major purpose of such spending quickly shifted from economic reconstruction to mutual defense. After 1952, much the most important form of extraordinary expenditure was not grants or loans but U.S. military expenditures abroad. While extraordinary in the sense of not being governed by normal commercial criteria, such expenditures have not been mainly determined by balance-of-payments considerations. Nor have they shown any tendency to decline. Unlike grants and loans, these expenditures have sharply reduced the

[1] These figures exclude U.S. Government grants and loans to international institutions.

current-account deficit of foreign countries with the United States, and for Western Europe in most recent years have transformed a deficit into a surplus. Such expenditures may be regarded as part of the cost of coexistence—a cost which is not likely to fall without a basic change in the international political scene.

Another blind alley that we should examine briefly before proceeding further is the possibility that the growth of American investment abroad may be the explanation for the reversal in the U.S. balance of payments. During the years 1950 through 1957, net private U.S. capital exports averaged $1.6 billion annually, as compared with an annual average of $0.7 billion for the years 1946 through 1949. This increase in capital exports, however, has not quite kept up with the increase in American income from foreign investments; such income averaged about $1 billion more per year in the period 1950–57 than in the period 1946–49. As long as so much new capital outflow is in the form of direct investment and as long as direct investment continues to be so profitable, there is little prospect that the growth of American investment abroad will exceed the related growth of income flowing back to the United States.

## II

Having disposed of extraordinary expenditures and the growth of American investment abroad as explanations of the reversal in the U.S. balance of payments since 1949, we find ourselves obliged to explain the reversal mainly, if not exclusively, in terms of normal payments and receipts on current account. That is to say, we must explain the reversal either in terms of a decline in American exports of goods and services or in terms of an increase in American imports.

The first of these alternatives we can immediately rule out. Even if we exclude from invisible exports the rapidly growing income from foreign investments, average annual exports of goods and services (excluding military exports) were about 10 percent higher in the period 1950–57 than in the period 1946–49. Thus the behavior of exports does not help to explain the reversal; on the contrary, it makes the explanation more difficult. With respect to imports, however, the story is very different, and here, I submit, lies the basic explanation for the shift after 1949 from an overall surplus to an overall deficit in the U.S. balance of payments.

At this point, it may improve our perspective if we return to the international economic horizon as it appeared to those of us who were reckless enough to make predictions at the beginning of the postwar era. Then, as now, we were very much concerned with the U.S. balance of payments. Our basic concern, if I may speak collectively, was with the supply of dollars flowing abroad. In 1946, most of those who feared a longrun dollar problem were more impressed with the possibility of an inadequate supply of dollars than with the possibility of an insatiable demand. In this connection, we owed a great debt to the then current Department of Commerce study, "The United States in the World Economy," by Hal B. Lary and associates. Lary had shown us that the flow of dollars was highly correlated with the level of American business activity and that this flow had fluctuated very widely during the interwar period. Indeed, the supply of dollars flowing to foreign countries declined by more than two-thirds from 1928 to 1933. With vivid memories of the depression, most American economists in early 1946 still felt that the longrun postwar problem after "reconversion" was more likely to be chronic stagnation than persistent inflation.

Apart from fears about the future level of American business activity, there was evidence, or so we thought, that the volume of U.S. imports was not very sensitive to price changes. This evidence seemed to suggest that American imports would not expand very much when the supply situation in war-ravaged countries improved. Thus, in 1946, there seemed to be ample reasons for fearing a world dollar problem arising from an inadequate or sharply fluctuating flow of dollars to foreign countries.

In this respect, however, American and British predictions turned out to be wide of the mark. Among the more sanguine prophets was Lord Keynes, who in his posthumous article of June 1946, predicted that U.S. merchandise imports, from a level of about $5 billion in 1945, might reach $6 to $8 billion when war-torn countries had recovered their productive capacity. This prediction, which assumed U.S. import prices at twice their prewar level, was widely regarded as overoptimistic. It was soon vindicated, however, and later shown to err on the pessimistic rather than on the optimistic side. As early as 1948, U.S. merchandise imports reached $7.6 billion, not far below the upper limit of Keynes' predicted range. By 1952, they had climbed to $10.8 billion, and in 1957, a year partly marked by recession, they amounted to $13.3 billion. It should be noted that these figures all exclude military imports. On a 1947 base, the dollar value of American imports in 1957 stood at 222, an average increase during the decade of 8 percent a year. Even after allowing for the rise in American export prices during the period, the dollars supplied to foreign countries in 1957 by U.S. merchandise imports could buy almost twice as much American real output as the dollars thus supplied in 1947.

The growth in American imports from Western Europe has been particularly striking. From 1947 to 1957, the dollar value of U.S. merchandise imports from Western Europe and dependencies (again excluding military imports) increased by more than three times. The rise during this period was at an average rate of almost 12 percent a year.

These rates of increase in American imports are much greater than the most optimistic would have predicted in 1946. Moreover, while there have been some ups and downs in imports during the pastwar years, the setbacks—particularly the setbacks traceable to recession—have been much more mild than had been generally expected. MacDougall maintains that a moderate U.S. recession might easily cut into foreign monetary reserves to the extent of $5 to $10 billion, and on the basis of interwar disturbances, such as the 1938 recession, this conclusion seems entirely reasonable. Yet this is certainly not the lesson of the recent recession. In the second half of 1957, U.S. merchandise imports were 4.7 percent higher than in the second half of 1956. Nor did they fall to any significant extent during the worst of the recession. In the second quarter of 1958, which marked the trough, imports were only 1.5 percent below the corresponding quarter of 1957. Moreover, this quarter, far from being characterized by a net inflow of gold and dollars, was marked by a net outflow of $1.1 billion, the result mainly of an abrupt decline in American exports.

## III

The sharp rise in imports since the war and the freedom from important setbacks attributable to recession raise questions which need more thorough investigation than is possible in this paper. If we compare 1957 with 1947, with figures for 1947 set at 100, we find that not only was the rise in the dollar value of merchandise imports (to 222) much greater than the rise in gross national product (to 188) but that the rise in the quantity of imports (to 168) was much greater than the rise either in industrial production (to 143) or in gross national product corrected for price changes (to 144). If we resist the temptation to explain away the problem by invoking a higher income elasticity of demand or a higher marginal propensity to import than was characteristic of the interwar period, I think we shall find that the rise in imports (or rather that part of the rise that is not explained by an increase in business activity) is attributable to a combination of factors operating in the same direction. In my ensuing discussion of these factors, I am not at all sure that I have set them down in the order of their importance.

In the first place, the 10-year period 1947–57 was marked by a 30 percent rise in the American price level, as measured by the overall price index published by the Department of Commerce to indicate changes in the price level of the gross national product. This rise in prices reflects a very considerable degree of inflation during the period. Other countries were of course also confronted with inflationary pressures, but in some cases were more successful than the United States in dealing with the problem. Moreover, a large number of countries become more competitive as a result of the 1949 devaluations, and any price comparisons between the United States and such countries over this period must take the change in exchange rates into account. My own view is that it is more than a coincidence that 1949, the year of devaluation, is also the year separating a period of massive overall surplus in the U.S. balance of payments from the subsequent period of overall deficit.

In the second place, there has been the recovery of Western Europe as a source of supply. In 1947, U.S. merchandise imports from Western Europe (OEEC) countries accounted for 12.2 percent of total U.S. imports. In 1957, imports from OEEC countries had risen to 22.2 percent of a much larger total. This seems mainly a reflection of European recovery, and it also suggests that the American demand for Western European goods is elastic with respect to price. If the demand had been inelastic, as some had feared, a shift to the right in the European export supply curve should have resulted in a fall rather than a rise in the share of total American imports coming from Western Europe.

A third factor that probably accounts for some of the increase in imports is a lower level of American tariffs. The ratio of duties collected to dutiable U.S. imports fell from 19.3 percent in 1947 to 10.8 percent in 1957. While not a satisfactory measure of tariff changes, these figures undoubtedly reflect a fall in the average of effective American tariff rates. The fall in tariffs (along with the recovery of Western Europe) probably accounts in large part for the increased share of finished manufactures in American imports. Imports in this category increased from 17.4 percent of total imports in 1947 to 27.3 percent in 1957.

If tariff reductions have played a significant role in the growth of American imports since the war, then we have another bit of evidence that the American demand for imports is more elastic with respect to price than some had feared in the forties. The fall in tariffs appears to have been mainly focused on manufactured goods, and if the demand for these had been inelastic, a fall in price to the American consumer should have led to a fall rather than a rise in the share of total imports accounted for by this category.

While I have no desire to reopen a statistical controversy on which much has been written, I would like to point out that the early empirical investigations of American import price elasticity were concerned with the demand for imports from the rest of the world as a whole. Since a large fraction of American imports has traditionally consisted of a rather short list of primary products, several of which are not produced in this countr,y it is not surprising that statistical studies based on interwar data should show that the American demand for output from the rest of the world as a bloc was inelastic with respect to price, particularly since much of the interwar period was characterized by high tariffs designed to exclude imports of other categories of imports, notably finished manufactures. This conclusion, however, is not really in conflict with evidence which shows that the American demand for imports may be highly elastic where prices in one foreign source of supply, say because of devaluation or because of a refusal to inflate as rapidly as other countries, fall in relation to prices elsewhere. Nor is the conclusion in conflict with evidence which shows that the American demand for imports may be highly elastic where tariffs have been lowered on items that had been protected precisely because the demand had been found to be sensitive to the lower prices prevailing abroad.

So much for the factors accounting for the postwar rise in American imports. What also requires explanation is the absence since the war of major setbacks in the level of imports that can be attributed to American recessions. In the recent recession, as we have seen, imports fell very little—much less, for example, than industrial production. Part of the explanation may be that U.S. imports, particularly imports of manufactured goods, are in large measure a function of disposable income, and that disposable income rather than falling during the recession simply stopped rising. Actually, disposable income has risen in every calendar year since the end of the war, and in the first half of 1958, when the recession reached its lowest point, was 1.1 percent higher than in the first half of 1957. This is a very different story from the big declines in disposable income characterizing the recessions and depressions of the interwar years. Thus the freedom from major setbacks in the level of imports during postwar recessions may be largely explained by the fact that, because of the growth of "built-in stabilizers," disposable income fluctuates less than formerly with the ups and downs of business, and also by the fact that a larger fraction of imports in the manufactured category makes American imports more closely geared than formerly to disposable income.

## IV

Up to this point in our discussion, we have established that the reversal in the U.S. balance of payments after 1949 has been primarily due to the rapid growth of American (nonmilitary) imports, and we have also tried to isolate the main factors responsible for this gorwth. In my remaining remarks, I would like to discuss briefly the effect of the reversal on the rest of the world and to indicate some implications for economic policy.

First of all, of course, the shift from a position of overall net surplus to a position of persistent net deficit has been the factor chiefly responsible for the spectacular improvement in recent years in foreign monetary reserves. Actually, foreign gold and short-term dollar holdings have slightly more than doubled since 1949, rising from $15 billion as of the end of that year to $30.5 billion as of June 30, 1958.[2] All major areas of the world have participated in this increase, though by widely varying degrees. Sharing less than the average increase were: Latin America, where gold and dollar holdings during the 8½-year period increased by only 40 percent; Asia, where such holdings rose by 63 percent; and the sterling area, where the increase was 78 percent. Sharing more than the average increase were Canada, where gold and short-term U.S. dollar holdings during the period increased by 126 percent, and—at the top of the list—continental Western Europe, where such holdings in mid-1958 were just over 2½ times as high as at the end of the forties.

While all major foreign areas participated in this increase in gold and dollar holdings, a few individual countries did not. Without naming names, it seems clear that in most such cases the difficulty was simply an excessive propensity to inflate.

I say "in most such cases," because there was another type of difficulty which, while it could be caused by an excessive propensity to inflate, was not primarily a current-account phenomenon. I am here referring to the type of problem experienced by the United Kingdom in the third quarter of 1957. In that quarter, British official gold and dollar reserves fell by $531 million, not because of adverse developments on current account—indeed, the sterling area at the time had a small curren-account surplus with the United States—but because of disequilibrating capital movements inspired by rumors of sterling devaluation. The dramatic way in which this situation, as a result of bold British monetary measures, was rapidly reversed shows that short-term capital movements, desipite the cold war, can still play an equilibrating as well as a disequilibrating role. If evidence is needed, these developments also show that important gold and dollar drains can and do occur that have nothing to do with the so-callerd "dollar problem."

Indeed, the dollar problem, in the sense of an excessive foreign demand for dollars in relation to the supply, has so long been a misleading description of the actual situation that some observers in this country have become deeply concerned about the opposite problem. In fact, in view of the substantial net outflow of gold and in view of the big increase in official dollar holdings that can be converted at will into gold by foreign monetary authorities, there have been suggestions in the financial press that the United States may soon have to begin thinking seriously about the prospect either of depreciating the dollar in terms of gold and foreign currencies or of discontinuing its present policy of freely selling gold to foreign central banks in exchange for dollars.

Such counsel seems to me decidely unwise. In the first place, at the present time almost half of total foreign gold and dollar holdings and about a third of foreign official gold and dollar reserves are in the form of dollars rather than gold. This has the great virtue not only of minimizing the outflow of American gold but of greatly increasing the world supply of convertible monetary reserves. The willingness of foreign countries to hold their convertible reserves so largely in the form of dollars is mainly a reflection of two considerations. First, because of its readiness to sell gold without limit to central banks in exchange for dollars at a price which has been unaltered since 1934, the United States has in effect made the dollar literally as good as gold from the standpoint of foreign monetary authorities. Indeed, the only rational reason for a foreign preference to hold reserves in the form of gold is the fear that the United States may some day change its gold policy without advance notice. Second, dollar reserves have actually been superior to gold in that they have earned a substantial return for foreign monetary authorities by being largely invested in U.S. Government short-term securities. The importance of this last factor was revealed earlier this year when, as a result of easy-money policies in this country, the yield on U.S. Treasury bills fell below 1 percent (from a yield of over 3½ percent as late as October, 1957). Partly because of this drop, foreign monetary authorities used their current dollar receipts, not to buy Treasury bills, but to buy gold from the U.S. Treasury. As a result, the large external deficit in the second quarter of 1958 was financed almost exclusively by a near-record net outflow of gold.

Despite the net outflow of gold and dollars since 1949, U.S. monetary reserves remain very high. Partly because of domestic gold production, partly because foreign countries have obtained gold for dollars from sources other than the

[2] These figures include private as well as official foreign dollar holdings, but exclude the gold and dollar assets of eastern European countries and of international institutions.

U.S. Treasury, but mainly because of the willingness of foreign monetary authorities to hold a large fraction of their reserves in the form of dollars, U.S. monetary gold fell from only $24.6 billion at the end of 1949 to $21.4 billion as of mid-1958. In view of the increase in foreign gold reserves, this represents a decline in the American share of the world total from 69 to 54 percent. That is to say, after 8½ years of external deficit, the United States still retains over half the world's monetary gold, even though its share of world imports is only about one-eighth.

Thus there is no need to be alarmist about the deficit in the U.S. balance of payments. So far as the past deficit is concerned, the United States has been performing a service for the world by promoting a better distribution of existing monetary reserves and thereby, perhaps, increasing the probability and longevity of coexistence. In so doing, the United States has also been performing a service for itself. For the deficit, which in some degree is the result of American inflationary tendencies relative to those abroad, has at the same time moderated the price increases that would otherwise have occurred in this country. Just as the overall external surplus before 1950 was an important source of inflationary pressure in the early postwar years, so has the external deficit of recent years been an important price-restraining influence.

This is by no means to deny that at some stage we may have to take positive steps to reduce or remove the external deficit. After all, it is a rare if not unique situation to be able to pursue domestic policies without taking into account their effect on the balance of payments. Luckily, because of our still very large reserves, there is no need for hasty action, for this is an area in which the remedies could easily be worse than the disease. In particular, it would be most unfortunate if, in dealing with the deficit, we were to yield to the temptation to introduce measures in the field of gold policy which would discourage foreign monetary authorities from holding reserves in the form of dollars. For, by adhering to policies which have encouraged foreign countries to hold their reserves in the form of dollars, the United States has greatly expanded the total volume of convertible monetary reserves.

In dealing with this problem, there is one area in which we can reasonably expect help from foreign countries, particularly from our Western European partners. One of the elements in the present balance-of-payments situation is the existence of foreign quantitative restrictions on purchases from the United States. Originally dictated by a condition of acute dollar shortage, these restrictions are now largely maintained, not to protect the balance of payments, but to protect foreign industries from American competition. Since 1952, great progress has been made in removing these restrictions, but much remains to be done. We can properly do our best to persuade other countries, both in their interest and in our own, to take further big steps in the removal of such restrictions. In this, as in the sphere of U.S. domestic policy to influence the balance of payments, we and our neighbors overseas will do well to bear in mind the final published words of Keynes that "we shall run more risk of jeopardizing the future if we are influenced by indefinite fears based on trying to look ahead further than anyone can see."

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## International Position of the U.S. Dollar

(By Bernard M. Bernstein [1])

In 1958, the outflow of gold from the United States amounted to $2,275 million, by far the largest reduction in U.S. gold holdings in any one year. In the first 5 months of 1959, there was a further outflow of gold amounting to about $346 million to May 20. When the additional U.S. subscription to the International Monetary Fund is paid within the next few months, the gold holdings of the United States will fall below $20 billion—the lowest level since June 1940.

While it poses no immediate danger to the exchange stability of the U.S. dollar, such a large and continued reduction in the gold stock of the United States is certain to be of great significance. Clearly, the U.S. Treasury cannot ignore this disturbing element in our international payments. In one way or another, means will have to be found to bring the outflow of gold to a halt. In order that

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these measures be appropriate to the economic situation in the United States and the rest of the world, it is important to understand the nature and the causes of the persistent outflow of gold.

It is frequently said that the outflow of gold is an indication of a loss of foreign confidence in the U.S. dollar. While doubts about the strength of the dollar are being expressed with increasing frequency, this is not the cause of the outflow of gold. The overall deficit in U.S. payments in 1958 (and the first quarter of 1959) was actually larger than the gold outflow. So far, there has been no net conversion of dollar balances into gold. On the contrary, foreign reserves in the form of U.S. dollar assets are still rising. The explanation of the gold outflow must be found in the factors that are contributing to the overall deficit in U.S. payments.

### DECLINE IN U.S. EXPORTS

Many observers have expressed the opinion that the weakness in the U.S. payments position may be explained by our exports. The steady inflation is supposed to have raised costs to such an extent that U.S. producers are pricing themselves out of world markets. The large decline in U.S. commercial exports in 1958 (and the first quarter of 1959) is cited as concrete evidence of this. While the recent fall in exports did aggravate the U.S. payments difficulties, there is no justification for the pessimistic view that the competitive position of the United States in world trade has been seriously impaired.

The fall in U.S. commercial exports in 1958 was exceptionally large, but it was entirely due to special circumstances. The Suez difficulties led to an extraordinary but temporary increase of U.S. exports to Western Europe and the Far East. From the fourth quarter of 1956 through the second quarter of 1957, U.S. commercial exports were $2.9 billion higher than in the corresponding period a year earlier. U.S. commercial exports rose to $17.3 billion in 1956 and $19.3 billion in 1957—an increase of 37 percent in 2 years. The rest of the world could not be expected to maintain such a high level of imports from the United States. It is not surprising that U.S. exports in 1958, excluding military transfers, fell to $16.2 billion—$3.1 billion less than in 1957 and $1.1 billion less than in 1956.

The large decline in U.S. exports in 1958 is due primarily to the disappearance of the unusual circumstances that caused the exceptional rise in U.S. exports in 1956 and 1957. According to the 1959 Economic Report of the President (p. 123): "By far the greater part of the recent decline in U.S. exports, as well as much of the sharp rise immediately preceding it, is attributable to developments in a few products. Six major commodities or commodity groups which usually constitute only about 30 percent of total U.S. exports accounted for most of the rise from the first half of 1956 to the first half of 1957 and for about three-fourths of the fall in the first half of 1958." The exports that have fallen so sharply are crude petroleum and selected fuels, coal and related fuels, cotton, wheat, iron and steel mill products and other metals and alloys, and automobiles and parts.

The fall in U.S. exports in 1958 (and the first quarter of 1959), although large, was in an environment of decreasing world trade. While U.S. recovery began in April 1958, the business situation in many of the great trading countries of Western Europe was still deteriorating. Furthermore, the sharp fall in the prices of primary products reduced the export receipts of the raw materials producing countries and impaired their ability to maintain imports. As business begins to expand in Western Europe and continues to expand in Canada, U.S. exports will probably show a cyclical recovery later this year and perhaps a considerable expansion next year. The recovery in U.S. exports will be facilitated by the rise in the prices of many primary products which appears to have begun.

### U.S. SHARE OF WORD EXPORTS

There is no doubt that the United States will be one of the principal beneficiaries of a resumption of the growth in world trade. It is a remarkable fact that the United States has been able to maintain almost the same relative share in total world exports throughout the period from 1950 to 1958, as shown in table I. Even in 1958, a depression year, U.S. commercial exports were a considerably larger part of the world total than from 1953 to 1955.

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TABLE I.—*U.S. exports as share of world total, 1950–58*

| Year | World exports adjusted [1] | U.S. exports [1] | U.S. share |
|---|---|---|---|
| | *Billion* | *Billion* | *Percent* |
| 1950 | $57.1 | $10.1 | 17.7 |
| 1951 | 76.2 | 14.1 | 18.5 |
| 1952 | 72.5 | 13.3 | 18.4 |
| 1953 | 71.8 | 12.3 | 17.0 |
| 1954 | 75.4 | 12.8 | 17.0 |
| 1955 | 81.5 | 14.3 | 17.1 |
| 1956 | 92.5 | 17.3 | 18.7 |
| 1957 | 99.5 | 19.3 | 19.4 |
| 1958 | 94.5 | 16.3 | 17.2 |

[1] Excluding special category exports (military aid supplies).

The United States continues to supply a relatively large share of world exports of manufactures, as shown in table II. It is such exports which would quickly reflect a deterioration in the U.S. competitive position in world markets. As would be expected with their reconstruction, the German and Japanese share of world exports of manufactures has risen from 14.3 percent in 1951 to 24.6 percent in 1958. Despite this, the United States has done as well as other industrial countries in maintaining its share of exports of manufactures in a world volume now 43 percent larger than in 1951. The U.S. share of world exports of manufactures, excluding Germany and Japan, was 30.9 percent in 1951 and 30.8 percent in 1958.

TABLE II.—*Shares in world exports of manufactures*

[Percent of total value]

| Year | United States [1] | United Kingdom | Germany | France | Japan | Others [2] |
|---|---|---|---|---|---|---|
| 1951 | 26.5 | 22.0 | 10.0 | 10.0 | 4.3 | 27.2 |
| 1952 | 26.2 | 21.6 | 12.0 | 9.2 | 3.8 | 27.3 |
| 1953 | 25.9 | 21.3 | 13.3 | 9.0 | 3.8 | 26.8 |
| 1954 | 25.1 | 20.4 | 14.8 | 9.0 | 4.7 | 26.0 |
| 1955 | 24.5 | 19.7 | 15.4 | 9.3 | 5.1 | 26.0 |
| 1956 | 25.2 | 19.1 | 16.4 | 7.8 | 5.7 | 25.8 |
| 1957 | 25.4 | 18.1 | 17.5 | 8.0 | 5.9 | 25.1 |
| 1958 | 23.2 | 18.0 | 18.6 | 8.5 | 6.0 | 25.7 |

[1] Excluding military aid exports.
[2] Belgium, Canada, Italy, Netherlands, Sweden, and Switzerland.

It is frequently said that because of our high costs, domestic producers are having great difficulty in competing with imports. Despite our large imports, amounting to $13.3 billion in 1957 and $12.9 billion in 1958, and spectacular imports of some products, such as small cars, foreign exporters generally do not find it easy to compete in the U.S. market. In fact, as can be seen from table III, U.S. imports in 1958 were smaller, relative to the gross national product, than in any year since 1951, except 1955. The United States has increased its purchases of import goods considerably in the last 8 years; it has increased its purchases of domestically produced goods and services even more.

TABLE III.—*U.S. imports and the gross national product*

[Billion dollars]

| Year | GNP | Imports | Imports, GNP (percent) |
|---|---|---|---|
| 1951 | 329.0 | 11.07 | 3.37 |
| 1952 | 347.0 | 10.79 | 3.11 |
| 1953 | 365.4 | 10.97 | 3.00 |
| 1954 | 363.1 | 10.30 | 2.99 |
| 1955 | 397.5 | 11.46 | 2.91 |
| 1956 | 419.2 | 12.74 | 3.04 |
| 1957 | 440.3 | 13.14 | 2.98 |
| 1958 | 437.7 | 12.94 | 2.96 |

If the U.S. competitive position has been impaired, it is not reflected in the export and import data. There is no convincing evidence that the United States is pricing itself out of world markets. Prices have, of course, risen in this country in the past 3 years. They have risen to about the same extent in Canada, slightly more in some Western European countries and slightly less in others. Competition in world markets is becoming much keener and the easy export markets of the past are gone. That is largely because with increased output the export capacity of Western Europe and Japan has greatly increased, not because U.S. costs have risen disproportionately.

### DEFICIT IN U.S. PAYMENTS

The emphasis on the recent outflow of gold and the recent decline in U.S. exports leaves the impression that the difficulties in U.S. payments have emerged in the past year. This is not so at all. In every year since 1950, except 1957, the balance of payments of the United States has resulted in a large accumulation of gold and U.S. dollar reserves by the rest of the world. In this period, the net gold sales of the United States have been over $3.7 billion and short-term U.S. dollar assets held by foreign banks and official institutions have risen by about $7.5 billion (table IV). Privately held short-term dollar assets of nonresidents have also risen by over $1 billion. This large transfer of reserves is the counterpart of the deficit in the U.S. balance of payments on current, capital, and aid account.

TABLE IV.—*Gold and U.S. dollar settlements, 1950–58*

[Million dollars]

| Year | U.S. gold sales | Increase in dollar holdings, foreign banks and official institutions |
|---|---|---|
| 1950 | 1,473 | 918 |
| 1951 | [1] −53 | 613 |
| 1952 | [1] −379 | 1,083 |
| 1953 | 1,161 | 1,021 |
| 1954 | 298 | 1,234 |
| 1955 | 41 | 702 |
| 1956 | [1] −306 | 1,112 |
| 1957 | [1] −798 | [2] −21 |
| 1958 | 2,275 | 845 |
| Total | 3,712 | 7,507 |

[1] Purchases.
[2] Decrease.

The outflow of U.S. reserves from 1950–58 is not the consequence of weakness in the U.S. trade position. In every year since 1950, U.S. commercial exports of goods and services have exceeded imports of goods and services by a substantial amount. As shown in table V, in 1958 the trade surplus was $3.3 billion, excluding exports and imports of military supplies under grants. On overall current account, again excluding U.S. military expenditures abroad and military aid supplies and services, the surplus in 1958 was $5.2 billion. Despite the decline in U.S. exports in 1958, the trade surplus and the current account surplus were the largest since 1950, except for 1956 and 1957, the years of the Suez crisis.

TABLE V.—*U.S. surplus on trade and current account, 1950–58*

[Million dollars]

| Year | Trade surplus | Current Account surplus [1] |
|---|---|---|
| 1950 | 1,009 | 1,856 |
| 1951 | 2,921 | 3,534 |
| 1952 | 2,481 | 3,757 |
| 1953 | 1,291 | 2,355 |
| 1954 | 2,445 | 3,849 |
| 1955 | 2,753 | 4,304 |
| 1956 | 4,530 | 5,981 |
| 1957 | 6,036 | 8,354 |
| 1958 | 3,263 | 5,232 |

[1] Excluding U.S. military expenditures abroad and military aid supplies and services.

The trade and current account surplus of the United States, excluding military expenditures and military aid, has been growing much larger in recent years, as can be seen from table V. This is not the balance of payments of a country that is unable to compete in supplying commercial goods and services in world trade. The explanation of the large and continued deficit in aggregate U.S. payments must be found in other sectors of the balance of payments—U.S. private foreign investment and U.S. Government expenditures and transfers abroad.

TABLE VI.—*U.S. private capital outflow and U.S. Government transfers abroad*

[Million dollars]

| Year | U.S. private net capital outflow [1] | U.S. Government expenditures and transfers [2] |
|---|---|---|
| 1950 | 1,265 | 4,742 |
| 1951 | 1,068 | 5,931 |
| 1952 | 1,158 | 6,940 |
| 1953 | 369 | 8,844 |
| 1954 | 1,619 | 7,318 |
| 1955 | 1,211 | 7,259 |
| 1956 | 2,980 | 7,836 |
| 1957 | 3,211 | 8,136 |
| 1958 | 2,924 | 8,449 |

[1] Excluding reinvested earnings of foreign subsidiaries of U.S. companies.
[2] Military expenditures, grants of military supplies, other grants, and U.S. Government net capital outflow.

As shown in table VI, there has been a substantial increase in new funds going into U.S. private investment abroad, particularly since 1956. There has been a very much larger increase in U.S. Government expenditures and transfers abroad which have risen from $4.7 billion in 1950 to $8.4 billion in 1958. With such a rapid rise in capital outflow and Government payments, it is not surprising that even the very large surplus on current account has been insufficient to avoid an overall deficit in U.S. payments which has amounted to a total of over $11 billion since 1950.

## IS THE U.S. DOLLAR WEAK?

It has become fashionable in recent months to speak of the dollar as a weak currency and to contrast it with the strong currencies of Western Europe. The strength or weakness of a currency is a complex concept, comprising numerous elements and manifesting itself in various ways. Of course, the U.S. dollar is a weak currency in the exchange markets in the sense that the exchange rates for the U.S. dollar, in terms of sterling, marks, guilders, and some other currencies, have been close to the gold export point for some time. The dollar is not, however, basically weak in the sense that the United States will be unable to maintain a well-balanced payments position over a longer period.

The trade surplus of the United States in the bad year 1958, amounting to $3.3 billion on commercial account, is the best evidence of the basic strength of the U.S. payments position. With economic recovery in Europe, the U.S. trade surplus will increase, if not in 1959 certainly in 1960. Furthermore, as the ratios of U.S. exports to world trade and of U.S. imports to the gross national product have been fairly stable, the trade surplus may be expected to grow when the expansion of world trade is resumed.

Apart from trade, the U.S. surplus on other current transactions, excluding U.S. military expenditures abroad, has been rising gradually and amounted to nearly $2 billion in 1958. This surplus in service transactions comes from the remitted earnings on U.S. investments abroad, which amounted to nearly $2.9 billion in 1958, and more than offset large U.S. payments for travel and personal remittances. Remitted earnings on U.S. foreign investments have doubled since 1950 and have been rising at an annual rate of about $200 million a year. On the other hand, remitted earnings on foreign assets in the United States were about $600 million in 1958.

The United States is an enormous capital creditor in the world economy. Its foreign investments and assets abroad amounted to $58.9 billion at the end of 1958, excluding the gold holdings of the U.S. Treasury. On the other hand, foreign assets in the United States, excluding the U.S. dollar reserves of foreign banks and governments, amounted to $20.8 billion at the end of 1958. U.S. foreign investments and assets abroad are not, of course, equivalent to monetary reserves. They are, nevertheless, an indication of the basic strength of the U.S. dollar and a source of large and growing receipts in the U.S. balance of payments.

TABLE VII.—*U.S. assets abroad and foreign assets in the United States*

[Billion dollars]

| | U.S. assets abroad, 1957 | Foreign asset in United States, 1957 |
|---|---|---|
| Direct investments | 25.3 | 4.8 |
| Long-term securities | 8.4 | [1] 8.0 |
| Short-term private | 3.2 | [2] 7.2 |
| U.S. Government [3] | 18.0 | (4) |
| Investment in 1958 | 4.0 | 1.8 |
| Total at end of 1958 | 58.9 | 20.8 |

[1] Excludes long-term U.S. Government bonds.
[2] Includes long-term U.S. Government bonds.
[3] Excludes gold holdings of U.S. Treasury and U.S. dollar reserves of foreign banks and official institutions.
[4] Foreign assets include private and public.

The United States is one of the great reserve centers of the world. Its gold reserves, therefore, must be sufficient not only to meet adverse balances in its own payments, but also transfers from countries that hold U.S. dollar reserves to those that hold reserves in other forms and under extremely adverse conditions, the conversion of U.S. dollar reserves into gold. At the end of 1958, the gold holdings of the United States amounted to $20.6 billion and its net creditor position in the International Monetary Fund was nearly $2 billion. At the end of 1958, short-term assets held in the United States by foreign banks and governments amounted to $12.2 billion. The reserves of the United States are ample for its trade and for all conversions of dollars into gold that foreign governments may want to make. They are not, however, excessive and they are considerably less, relative to needs, than they were 5 years ago.

TABLE VIII.—*Monetary reserve position of the United States*

[Billion dollars]

| End of year | U.S. gold holdings | Net International Monetary Fund position | Liabilities to foreign official institutions [1] |
|---|---|---|---|
| 1949 | 24.56 | 1.45 | [2] 6.03 |
| 1950 | 22.82 | 1.45 | 5.72 |
| 1951 | 22.87 | 1.43 | 6.14 |
| 1952 | 23.25 | 1.46 | 7.28 |
| 1953 | 22.09 | 1.37 | 8.24 |
| 1954 | 21.79 | 1.19 | 9.34 |
| 1955 | 21.75 | 1.04 | 9.94 |
| 1956 | 22.06 | 1.61 | 11.46 |
| 1957 | 22.86 | 1.98 | 11.38 |
| 1958 | 20.58 | 1.96 | 12.19 |

[1] Includes foreign banks; excludes international institutions.
[2] Includes foreign private U.S. dollar assets in 1949.

ALTERNATIVE CORRECTIVE MEASURES

However strong its current payments position may be now or may be expected to become later, no country can draw down its net reserves indefinitely. There is no imminent danger that our monetary reserves will prove inadequate, but the United States cannot be indifferent to the need to restore balance in its overall payments. Even the United States cannot afford to sustain a continued deterioration in its reserve position on the scale of recent years. The outflow of gold has given a dramatic quality to the deficit of 1958, but the problem would not be essentially different if the deficit had been accompanied by a substantial increase in short-term dollar liabilities to foreign banks and official institutions.

Ordinarily, with its basically strong payments position and its substantial reserves, the United States could wait for several years until the forces of expansion in the countries acquiring gold and dollars bring about a reversal in the overall deficit in U.S. payments. After 8 years, this is no longer a practical policy. The countries of Western Europe have acquired nearly $8 billion of gold and over $5 billion of foreign exchange since 1950 without any indication that their rapid accumulation of reserves is at an end. So long as these countries are determined to increase their reserves on a large scale, the United States will continue to have a substantial overall deficit in its payments. For this reason the United States must take positive measures to maintain its reserve position.

One alternative is to attempt to strengthen the current account surplus of the United States by generating a larger volume of exports and a smaller volume of imports. This would entail deflation in the United States and would induce a partially offsetting degree of deflation in some other countries. Such a policy would be unwise and is uncalled for. The U.S. economy is about as free of inflation as that of any other great industrial country. There is no need to impose restrictive measures that would hamper the growth in production and employment. Furthermore, it is not at all certain that such a policy by the United States would be effective. The success of any measures taken by the United States to increase its current account surplus would in large part depend upon complementary measures taken by other countries to expand their own consumption and investment.

The apparent weakness of the U.S. dollar does not arise from an impairment of the international economic position of the United States but from the restoration of the naturally strong economic position of other areas, particularly Western Europe. For several years, the output of the great trading countries of Western Europe, plus aid from the United States, has been sufficient to meet all their needs for domestic consumption and investment and to leave a large surplus for investment abroad and for accumulating reserves. In 1958, this surplus of resources was so large that Western Europe acquired about $3.5 billion in gold and foreign exchange reserves. It is this basic fact that provides the key to the solution of the U.S. payments problem.

An enduring change has taken place in world payments. The industrial countries of Western Europe have once again become a great and growing producing center. They have shown their capacity to compete with the United States in world markets. With few exceptions, they have already made good the postwar deficiency in their reserves. They do not need all of the $3.4 billion of transfers and payments (military expenditures, grants of military supplies, other grants, and U.S. Government net capital outflow) that the U.S. Government made to them and for them in 1958. A reduction in U.S. Government transfers to and expenditures in Western Europe would not result in an equal improvement in the U.S. balance of payments, but there is no doubt it would have a substantial favorable effect.

Because so much has been said about the possibility of a devaluation of the U.S. dollar or of a rise in the price of gold in terms of all currencies, some comment is necessary on this point. Neither this administration nor any succeeding administration would give serious consideration to these proposals. With its basic strength in international trade and payments, such an extreme step by the Uinted States is unnecessary and would be unwarranted. The particular cause of the outflow of gold over the past 8 years is the rapid increase in U.S. Government transfers and payments abroad. A reduction in such expenditures and transfers in Western Europe is a difficult measure to undertake, but it can be done without adverse effects on our diplomatic position in Europe and with favorable effects on the well-being of the underdeveloped countries.

### CONCLUSIONS

In a strongly competitive world, no country can be indiffeernt to the impact of its policies on its international payments. Policies that were bold and essential a decade ago must be modified to conform to the needs of a world that is now radically different. The United States has the capacity to increase its aid to countries that need real resources to enable them to maintain their development—that is, the underdeveloped countries. It cannot continue to provide aid to countries merely to enable them to acquire reserves of gold and U.S. dollars.

The time has come for a new stage in U.S. payments policy. From 1946 to 1951, the U.S. policy was to provide aid to Western Europe to acquire the real resources necessary for their reconstruction. Since 1952, the U.S. policy has been to continue U.S. aid and expenditure, largely for military purposes, while the rest of the world restored an adequate level of reserves. The new U.S. policy should be one of greatly reduced aid and expenditures for Western Europe, larger U.S. and European aid for underdeveloped countries, and a moderate growth of reserves for all the great trading countries. With the increase in the resources of the International Monetary Fund the need for massive additions to Western European reserves has passed. In fact, most of these countries are in a position to eliminate completely all remaining restrictions and discriminations and to participate in international trade and investment on the same free basis as the United States.

With an international payments policy that recognizes the realities of the economic world of today, there need be no fear of the capacity of the United States to maintain its economic leadership among the great trading countries. The United States is a country with enormous productive capacity whose costs remain sensitive to business conditions. The monetary policy of the United States is cautious and its fiscal policy is conservative. It has added about $40 billion to its foreign investments between 1946 and 1958, about $27 billion of which was on private account. Its reserves of $20 billion provide it adequately with the liquidity necessary for a great reserve center. The U.S. dollar must continue to be first among a larger group of strong, convertible currencies.

The CHAIRMAN. I am very glad indeed, Mr. Baldwin, to have you here.

Mr. Baldwin is professor of economics at the University of California.

Senator JAVITS. Mr. Chairman, may we ask questions now?

The CHAIRMAN. I started the precedent in asking question of Mr. Lederer. I therefore feel I should extend the same right to you; and if you would like to ask questions now, you may.

Senator JAVITS. If the chairman would prefer to have the next witness proceed, I will wait, Mr. Chairman.

The CHAIRMAN. I think it would be well.

## STATEMENT OF ROBERT E. BALDWIN, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Mr. BALDWIN. The sharp drop in our export surplus during the last year seems to be based mainly on short-term economic changes abroad. Nevertheless, there are several factors in the balance of payments picture that do raise problems concerning our prospects for maintaining adequate growth over the long run.

A basic shift in the U.S. trading pattern that has been taking place for many years is an increasing emphasis upon exports of manufactured commodities, especially capital goods, and a greater dependence upon the importation of certain raw materials. In 1928, for example, manufacturers constituted 45.7 percent of our total merchandise exports. By 1948, this figure had increased to 55 percent, and in 1957 it was 61.4 percent. Moreover, by 1957, 53.7 percent of these manufactures were machinery and vehicles.

One consequence of this shift toward capital goods is that our export trade has become increasingly sensitive to the level of industrial activity in foreign countries. Fortunately, since World War II the tremendous demand for capital goods on the part of both underdeveloped and industrial countries has kept these exports steadily rising.

Capital goods exports rose 44.5 percent between 1952 and 1957. However, the leveling off of industrial activity in Western Europe, recessions in Canada and Japan, and recent balance of payments pressures in several important underdeveloped countries caused these exports to decline $0.5 billion between 1957 and 1958.

In addition to this cyclical problem, the United States has been facing increasing competition in the manufactured goods field from other industrial nations. Our share of the exports of manufactured goods by the major industrial nations—United States, United Kingdom, West Germany, France, Belgium-Luxembourg, Japan, Canada, Italy, and Sweden—fell from 34 to 32.1 percent between 1952 and 1957 and our share of capital goods exports from 44.2 to 37.7 percent.

After the war, the lack of adequate facilities abroad enabled the United States to increase its share of the manufactured goods market from 22 percent in 1938 to 34 percent in 1952. But, as these countries have gradually expanded their industrial production under the protection of foreign exchange control, they have been able to compete more and more successfully with the United States. They have done so well that they have now been able to restore nonresident convertibility.

The 140 percent increase in our imports of machinery and vehicles—70 percent if trucks and passengers cars are excluded—between 1952 and 1957 indicates their success in this field. Despite the drop in demand in this country because of the recession, imports of machinery and vehicles actually increased about $450 million between 1957 and 1958.

The growing dependence by this country on certain raw materials is reflected in the remarkable increase between 1952 and 1957 in our imports of oil, iron ore, and aluminum. These three items accounted for $1.2 billion of the total $2 billion increase in our imports between 1952 and 1957. Adding the $0.8 billion increase in machinery and vehicles to this figure accounts for the entire $2 billion increase in our imports during this period.

Moreover, were it not for quotas on a number of agricultural commodities and metals our imports would have increased much more. The greater use of quotas to restrict excess demand, coupled with our shift toward capital goods exports means that, while our exports are becoming more sensitive to fluctuations in foreign demand, our imports are becoming less sensitive to cyclical fluctuations.

Although exports of raw materials and agricultural products also have increased in recent years, this rise can hardly be regarded as very encouraging from a long-run point of view. The $220 million increase in petroleum products exports in 1957, for example, reflected mainly the Suez crisis. But, more important, consider the $670 million increase in exports of agricultural products between 1954 and 1957.

This increase was the result of a $1.1 billion increase in agricultural exports under Government programs and a $0.4 billion decrease in sales outside these Government programs. The decline in non-Government-sponsored exports would have been even larger had it not been for poor harvests abroad in 1957. By 1957 about $2 billion of our agricultural exports were subsidized in one form or another.

Thus, the United States now finds itself in a balance-of-payments situation that is entirely different from the easy days immediately after World War II. We are increasingly dependent up exports of manufactured goods and yet subject to increasing competition in this field. This latter development is reflected both by our declining share of the international market and the rapid increase in our machinery and vehicle imports. At the same time our imports of such raw materials as oil, iron ore, and aluminum have grown at a remarkably rapid rate. We have maintained a sizable export surplus despite these shifts, but in reality this export surplus has been due in large part to temporary developments abroad, plus our programs of export subsidy and import control.

A great danger for the American economy is that we shall attempt to meet balance-of-payments problems by further restrictions rather than by the needed shift in resources. The recent imposition of oil quotas is a discouraging sign. Restriction of imports and subsidization of exports is not only inflationary, but more important it tends to restrict our economic growth.

The major economic policy problem we now face is not the question of whether we can achieve growth without inflation, but the more fundamental one of whether we can maintain the flexibility in our resources that is required to achieve satisfactory growth.

If we freeze more and more of our labor and capital in inefficient industries, we are prevented from shifting resources into new and expanding lines of production as rapidly as otherwise possible. Since we have no control over the actions of foreign competitors, the long-run cost of a restrictionist policy is a declining share of the world export market and a growing demand for imports.

One answer to the problem, of course, is to allow the price system to operate more freely and thereby force resources out of inefficient industries. As we have become wealthier, there has been a growing reluctance to allow the price mechanism to operate freely when the required adjustment will inflict severe hardships on a particular economic sector. We must begin to reverse this trend, unless we are prepared to run the risks of general inefficiency.

But, in addition, the Government should aid the resource adjustments required by changing technological and demand conditions by positive programs designed to promote resource flexibility. Instead of protecting every weak sector that appears, we should provide inducements to encourage labor and capital to move out of these fields.

As far as the sharp drop in exports last year and the associated gold outflow is concerned, this situation should improve within the next year or so as industrial activity continues to expand abroad. The recent removal of many of the foreign restrictions against the importation of U.S. goods should also act to increase our exports.

The fact that no dramatic increase in our exports to these countries has occurred so far should not be taken to mean we shall not be able to penetrate their domestic markets. Competition in manufactured goods is based on much more than price. It will take time for U.S. manufacturers to build up the sales and servicing staffs that are necessary for effective competition—just as it has taken several years for foreigners to penetrate the U.S. market for machinery and vehicles.

One factor that should be watched, however, in the gold outflow is the conversion of dollar balances into gold based upon the expectation that we shall increase the price of gold. Raising the price of gold at this time would be very unwise, and if this speculative outflow becomes significant, the administration should make a firm statement that we have no intention of increasing the price of gold.

Although the rather heavy gold drain of the last year and a half should cease before long, one should not expect any significant reversal of the movement of gold. Western Europe, in particular, is now in a position to compete effectively with the United States. This strengthening of Western Europe is a development that we should welcome, since it means that the free world is more capable than ever of meeting the economic and military challenges of the Communist bloc. One consequence of this improvement, however, is that Europe should now increase its military contributions to the common defense of the free world. In addition, they should take a more active role in aiding the underdeveloped, neutral nations to achieve their development goals.

These actions will not only directly contribute to a strengthening of the military and economic position of the West, but they will act to relieve some of the pressure on the balance of payments position of the United States.

The CHAIRMAN. Mr. Coffin, do you have some questions?

Representative COFFIN. Thank you, Mr. Chairman.

Mr. Baldwin, you have carried the testimony of the other witnesses to perhaps a very basic field of policy when you say that our prime need, if I understand you, is to inject flexibility in resource utilization. You have also said that Government should aid this by extending positive inducements to labor and capital to move out of relatively inefficient fields.

What kind of inducements do you have in mind?

Mr. BALDWIN. Such things as labor retraining programs; loans to firms in declining industries in order to help them move into expanding fields; loans to workers for the purpose of aiding their migration to different regions; research grants by the Government to develop opportunities in new lines of production; and information services to both labor and management concerning opportunities in other areas and industries.

We need a positive program to help move inefficient resources into new lines rather than programs that merely support these resources in the inefficient industries.

Representative COFFIN. These things are contained in depressed areas legislation that our chairman has had quite a bit to do with. That is the kind of thing you have in mind?

Mr. BALDWIN. Yes.

Representative COFFIN. Going beyond that, are there inducements or are there programs that have been entered into by other countries that shed any light as to what could be fruitfully done here?

Mr. BALDWIN. First, we should undertake the type of activities I mentioned on a much larger scale than we are at present. In addition, I think the incentive taxation programs adopted in West Germany possess considerable merit. We might, for example, permit firms moving out of declining industries to accelerate their amortization of equipment or to pay lower taxes until they become established in new lines. Similarly, we could provide a larger tax exemption on personal income for workers who move from a relatively depressed to a more vigorous region.

Representative COFFIN. You and Mr. Kindleberger have testified that you thought that the present condition of Europe indicated that they should bear a larger proportion of aid to underdeveloped countries, and perhaps the military burden should be shared to a greater degree.

This question could be asked of either you or Mr. Kindleberger, because he made the statement that foreign aid should reflect the balance-of-payment situation.

If we tried to negotiate with our European allies and tried to sell that proposition, they would point out that their per capita income was far lower than ours. They would point out that their total tax burden, excise, income, and other, is in most instances higher than ours.

What kind of a formula is economically sound? That is, can we say that the balance of payments should be the magic key to a basic resharing of aid to underdeveloped countries?

Mr. BALDWIN. The condition of their balance of payments certainly is one factor but obviously not the only one. The rate of increase in industrial production and per capita income, the condition of the budget, the level of employment, and the behavior of prices are other factors that should be considered. In short, conditions in all parts of the economy must be taken into account.

Representative COFFIN. But how do you reason that their per capita income is still maybe a third or two-fifths of ours?

Mr. BALDWIN. The fact that it is lower does not mean that they shouldn't share more of the burden than they are currently sharing. I do not propose that their share should be as large as ours. However, because gross national product and industrial production have increased more in Western Europe than in the United States in recent years and because their balance of payments position has improved markedly, I am suggesting that these countries are now able to increase their share of the foreign aid expenditures by the free world. Do you want to comment on the question, Mr. Kindleberger?

Mr. KINDLEBERGER. I would want to comment that some of this would come about automatically through the increase in German expenditures for its own armaments. Germany has, up to now, achieved a large amount of its export surplus because of the fact that it was raising taxes to pay for armaments, but not spending the money for armaments.

They have had big treasury surpluses with these armament taxes which were not spent. From now on, however, the pace of expenditures is going to pick up and the pace of taxes will not, which will create a more inflationary bias in Germany. And this is going to mean effectively that their balance of payments of surplus is going to be cut down.

The Germans have been very slow in national defense expenditures, and we have been very fast in this regard. All I am suggesting is that we get back into some appropriate balance.

I think it is true that it is a mistake to say balance of payments should determine who contributes what. That is a simple error. We can pay for anything we want to if we want to. All I am suggesting is, since we are having a little trouble with our balance of payments and they are having things so pleasant with their balance of payments, maybe we ought to share it a little bit.

But if they would argue and we agreed that because we are richer they should pay less, we can, by increasing taxes and by cutting down expenditures in this country, redress the balance of payments, correct that, and pay a bigger share. But I do not think I would urge it at this time.

Representative COFFIN. Mr. Schmidt's basic idea is to bear in mind these trends and all of the items that make that up should give us concern, but he stated to Senator Javits that he would wait and see what the future holds.

I think the future is going to hold some new activity in the field of aid to underdeveloped nations by Europe. I know Mr. Halstein of the Common Market indicated that there was deep interest in extending aid to underdeveloped countries now.

But I would be interested in having our Government explore a reasonable proposition as far as establishing a basis for sharing is concerned. Political considerations will always be the most important, and yet if we come up with a series of factors which should be taken into account, this might be persuasive; and I do not think it would meet with resistance if we did it in the right atmosphere.

Mr. KINDLEBERGER. I think it is fair to say, sir, that the basis on which the original NATO sharing in 1950 took place included as one strand of the reasoning that the U.S. balance of payments surplus was so large.

As this begins to come down a little bit, the original basis for sharing worked out in NATO in 1950 and thereafter might be modified a little bit.

Representative COFFIN. One final question, Mr. Chairman, and then I will yield.

I would like to ask Mr. Lederer whether he has information that would indicate the source of the accumulation of gold in Western Europe. We know that Germany has exported less to us than it has imported from us, and yet it has accumulated gold.

Do you have information as to how much gold they have gotten directly from the United States and how much gold they have gotten from third countries, possibly as a result of aid transactions?

Mr. LEDERER. I cannot answer for Germany itself, but only for all Western Europe. Our net payments to Western Europe in 1958, as far as we can tell, were about $1.6 billion. Their total accumulation was about $3.7 billion. So the difference is something around $2 billion which they may have gotten indirectly, through transactions through third countries.

Representative COFFIN. You do not know whether those transactions were the result of aid or a combination of aid and trade?

Mr. LEDERER. It is obviously the total, a combination. As for aid itself, I have looked into that once. It seems that in 1958 out of the nonmilitary aid, about half a billion dollars or so represents offshore purchases, that is, purchases in third countries; and a very large part of that was spent in the advanced countries, say around $350 million or so out of the $500 million; this includes about $250 million spent in Europe and about $100 million in Japan.

Representative COFFIN. That would be $250 million out of $2 billion?

Mr. LEDERER. Yes.

The CHAIRMAN. Senator Javits?

Senator JAVITS. I had in mind to pursue with Professor Kindleberger the rather affirmative recommendation which he makes for our country. I think this is what the country is waiting for: What do we do? I would like to take these in turn.

First, you say that—

> U.S. producers seem ponderous—slow to make decisions, and far from daring—in their attempts at imitation.

They are getting a little fat, in other words. I notice you pick up the same theme at the very end of your paper where you say:

> Generally speaking, it seems inappropriate for management to blame imports on wages—

that is, the wages of domestic labor—

> or for labor to ascribe them—

that is, the keener competition abroad—

> to administered pricing or a loss of innovational leadership. The appropriate answer is rather more productivity, including new cost reductions and new useful products.

In other words, what you are really saying is that American labor and American management have to get on the ball——

Mr. KINDLEBERGER. Yes, sir.

Senator JAVITS. Get more competitive, sharpen up their pencils, flex their muscles, and do a more active job, more in the tradition of people who are trying to get ahead than of people who have arrived. Is that right?

Mr. KINDLEBERGER. Yes, sir.

Senator JAVITS. Would you advise that we give some stimulus to that activity, for example, by more favorable tax treatment for depreciation of new items, or some modified depreciation policy, in order to encourage new installations which will cut down on costs?

Mr. KINDLEBERGER. I am afraid this takes me well out of my field, sir, and I would prefer not to speak to this.

Senator JAVITS. But what you are seeking to convey to us is the general principle of their innovation, activity, their productivity as being vitally important?

Mr. KINDLEBERGER. Yes, sir; and I wanted to suggest in some industries which seem to me very vigorous and active, as in chemicals, exports to Europe are rising rather than falling.

Senator JAVITS. The next thing you point out to us is in terms of the very hot argument about a balanced budget, that what we need to do is make our intake more nearly equal our outgo. In short, we have to be just as ready to increases taxes if we have to, to close up tax loopholes which my colleagues have been waging quite a struggle on in the last few days, and not be be afraid to pay the bill or, rather, not to be reluctant about paying the bill if we have to make these expenditures which represent the bill. Is that correct?

Mr. KINDLEBERGER. Yes; that follows, I think.

Senator JAVITS. And you feel the country has adequate capacity still to do that?

Mr. KINDLEBERGER. Oh, yes. There is no doubt about it.

Senator JAVITS. And yet not overtax themselves by any means?

Mr. KINDLEBERGER. Certainly not.

Senator JAVITS. Taking into consideration the order of magnitude of the type of expenditure we have, that is your prescription No. 2?

Mr. KINDLEBERGER. Yes, sir.

Senator JAVITS. Enough taxes; increase them if necessary—and it may be necessary—fill up loopholes; take in more money; don't be afraid to spend more money. You can well afford it if you take in more money and tax yourself.

Mr. KINDLEBERGER. Exactly.

Senator JAVITS. Now, point 3: You feel that the time has come to invite the free world to undertake some of our burdens in respect of aid to the less developed areas. That is correct, is it not?

Mr. KINDLEBERGER. Yes.

Senator JAVITS. And the test which you utilize is, and I quote:

> So long as U.S. aid and investment substantially exceed the current-account surplus of this country, and the current-account surplus of European countries is larger than their investment and aid, there is a case for shifting the present distribution of aid before undertaking any enlargement of it.

Do you have any figures or any amounts of the current-account surpluses of European countries in relation to their investment in aid?

Mr. KINDLEBERGER. I am afraid I do not. I have some old figures; I have some end of 1958 figures for their gold and dollar reserves, and I have some 1957 figures for their balance of payments, which are the most recent.

Senator JAVITS. Do you believe it very desirable that such a study be made?

Mr. KINDLEBERGER. Oh, yes, very much.

Senator JAVITS. And you believe it very desirable that a major effort be made by the United States on a multilateral basis to induce some of our partners, notably Germany, which has rather large resources now, France, perhaps other countries, to undertake with us some of the responsibilities for aid that we have been carrying ourselves?

Mr. KINDLEBERGER. Yes, I think I would wait a little bit on France. President de Gaulle, as you know, has already spoken in a positive sense. He is very eager to get in on the act and to become a developed, mature country.

But the German balance of payments is the one that seems to me to need to be funded. The Germans have been having an export surplus now since 1951. They have been making long-term investments on a strictly ad hoc basis, such as the reparations to Israel, but these are about over now.

Senator JAVITS. I have been thinking, Professor Kindleberger, myself, of offering an amendment to the Mutual Security Act to require a study to be made of this question. That is why I asked you whether you had any facts and figures on it. As far as I am aware, our Government has not in a deliberate way gone about doing this.

I happen to be very active in an organization called the NATO Parliamentarians. I am the chairman of its economic committee. I have been beating the drum for this for 2 years. I must say I am very pleased to see an experienced economist come to these conclusions at the same time.

I ask you whether you feel that the body of information we have on this subject could well stand consolidation through some governmental study which would put it in focus for Congress and the American people?

Mr. KINDLEBERGER. Very readily, yes, sir.

Senator JAVITS. You would think that would be a constructive move?

Mr. KINDLEBERGER. I do, sir.

Senator JAVITS. You encourage me.

May I ask—and this is a suggestion of our distinguished chairman—and Mr. Chairman, may I parenthetically say that in all my years in Congress, and I have been here since 1947 off and on, mostly on, I have never seen as instructive a set of hearings as the chairman of this committee is conducting this year. This is one that is likely to produce extraordinary results for our people at ridiculously low cost compared with what we spent on the TNEC and other similar inquiries.

The CHAIRMAN. I thank the Senator, but I think the credit is largely due to both the staff of the committee and the witnesses who have been kind enough to come and devote their time and energies. The thanks should be due to them, not to me.

Senator JAVITS. Mr. Chairman, the question I was going to put was a question to all three colleagues, if they wish to answer, or Professor Kindleberger. Could we have a commentary from Mr. Lederer, and then Professor Baldwin and Professor Schmidt, on the precise answers which we now have? If I may recapitulate, because I think they are very important, the three things we are urged to do are:

1. American management and labor to quote, my own quote, "get on the ball" in respect of the acumen and skill and vigor with which they address themselves to their tasks.

2. Endeavor to redistribute the aid problems which we have in terms of foreign aid, et cetera, among more of our partners that are carrying this burden today.

3. Tax ourselves more in order to meet the responsibilities which we have to meet, and show no fear in meeting those responsibilities.

Is that summary agreeable to Professor Kindleberger?

Mr. KINDLEBERGER. Entirely.

The CHAIRMAN. May I say that since Mr. Lederer is an official of the Department of Commerce, we should leave him out? I do not believe we should ask him to express a policy now. But these other gentlemen are free men.

Representative COFFIN. Was there not a fourth definite suggestion made, though, by Professor Baldwin, with regard to means of inducing more flexibility in our own resources?

Senator JAVITS. Would you state that, Congressman Coffin? And then they can make a reply.

Representative COFFIN. First of all, they made a point that there was a need for our industrial potential to go to areas of maximum efficiency, in that government has a role to play in inducing labor and capital to move into such fields.

Senator JAVITS. Thank you. I will adopt that, and let us say that is a four-part recommendation.

Could we have the comments of the other gentleman on that?

The CHAIRMAN. Mr. Schmidt?

Mr. SCHMIDT. On the first point, about getting on the ball, this is the first time I have heard it proposed that we should have jawbone control of the balance of payments. It will probably not be any more successful, I think, than the jawbone control of the price level. I think the job is to set the framework in which American enterprise and the other factors of production can do a better job. I think this is in large measure in the hands of you gentlemen.

On the redistribution of aid, I would simply warn that we may be able to use the balance of payments as a bargaining device, as a debate argument, but I would not wish to see us take any action in this area simply because of the balance-of-payments condition.

On the tax-ourselves-more question, I would also add that we could spend less. This is always an alternative.

And on the flexibility, again I think that Congress might well look very closely at govermental regulations to see if some of those might be reduced in order to increase that flexibility, and also perhaps take more action in the antitrust field.

On the redistribution of aid, Senator Javits, this is a very tricky area, and I would hate to see us jeopardize what some people consider a very vital area of American foreign policy, just because of gold. Here, on the one hand, we have Mr. Bernstein suggesting a reduction of assistance and expenditures in Western Europe, and at the very same time the Draper Committee is telling us that we have to increase military expenditures to Western Europe for our own security.

The CHAIRMAN. Who says that?

Mr. SCHMIDT. The Draper Committee.

I think it would be a very serious error to overlook the judgment of the generals; in this case, the competent people in judging the risks. Look at the problems we face. I am not very close to the operational side of this question, but I have been told by people that they have proposed a reduction of U.S. military assistance of certain items to a particular country, and then the military officers on the other side in Western Europe will say, "Oh, no, we will cut down our activity by an equal amount."

If we are going to run into this kind of problem, aid reduction will not reduce our worries about the gold stock; we must do something else.

Senator JAVITS. I must say I yield to no one in my devotion to the foreign assistance program of the United States, and I have proved that on a thousand battlefields. Yet I believe that it is time to make our European partners join in, and I think the best proofs of that are India and Turkey, where under the exigency of an emergency they did join in, and to very great effect. I think there is great leverage there. I think the program has to be increased. I do not think it is necessary for us to increase it alone. I think this is the place where they come in, and I feel that the time has come to speak very frankly to our allies on that subject.

Mr. SCHMIDT. I am in complete agreement with your conclusion. All I am urging is that it not be done because of the balance-of-payments condition, but on the principle that they are wealthier, or something like that.

Senator JAVITS. In other words, we do not need it because we are poor, but we need it because it should be done that way in all honesty, and that our sacrifices should not be unlimited.

Mr. SCHMIDT. That is true.

Senator JAVITS. Thank you very much, Mr. Chairman.

The CHAIRMAN. Mr. Baldwin, do you have anything to say?

Mr. BALDWIN. Yes; I would concur with these four points. Certainly we should exhort business to be as efficient as possible. I doubt, however, if too much can be accomplished merely by urging them to be efficient.

The CHAIRMAN. May I ask this? It would not surprise me at all if the automobile manufactures came in very shortly and proposed tariffs on foreign cars. If they make that proposal, do you think we should comply?

Mr. BALDWIN. Oh, no. The Government should not impose additional restrictions of this kind. Such measures just make resources more immobile and in the long run cause greater difficulties in the foreign sector. The way to keep American industry efficient is to force it to compete with foreign countries. In addition, as I said before, more positive programs to promote resource flexibility should be undertaken.

I also agree with the suggestion that our allies should increase their share of the West's foreign aid expenditures. I would like to stress, however, that I do not think we should cut down on our foreign aid but that we should ask them to increase their expenditures. We should keep our level of aid about where it is and urge our allies to increase their aid, particularly to the underdeveloped countries.

Representative COFFIN. So that really, when you started up by saying that you agreed to have each of them share our foreign aid, that is not accurate; is it?

Mr. BALDWIN. No; not in the sense that the change in the sharing arrangement means an absolute decrease in our foreign aid and an increase in theirs. Keep ours at about its present level, or perhaps even increase it, but bring about a better sharing arrangement by having them increase their foreign aid relatively more than we do.

Certainly as far as the taxation is concerned, I fully agree that we are not near what I would consider a tax limit, and that we should increase taxes to finance any larger expenditure programs.

The CHAIRMAN. Senator Javits?

Senator JAVITS. I have no further questions.

The CHAIRMAN. Mr. Kindleberger, I noticed that you warned against attempts at deflation in this country. Is that correct?

Mr. KINDLEBERGER. Yes, sir.

The CHAIRMAN. The argument is being heard that many of our products are at a competitive disadvantage compared with European, particularly German and Belgian, and also Japanese products, and that therefore we must reduce costs of production; and the way to do this is by holding down wages while output rises, so that labor costs will develop into a fall.

What is your general criticism of that opinion?

Mr. KINDLEBERGER. My view is that the kind of industries in which this would work are not those in which we are likely to do much exporting. Let me cite an example, sir, of a young friend of mine who is a businessman, who told me that they were being bothered in his company by flashlights from Hong Kong at 29 cents, when their flashlights sold for $1.79. He said it is hopeless to try to meet this kind of competition directly, but that they were able, by putting a research team on this, to get a much better flashlight, three times as good as the Hong Kong flashlight, for 79 cents.

I don't know why the figures all end in nine, but they do.

This is the way to meet the competition from Hong Kong flashlights. To my mind, to try to stay with your old product and squeeze down the wages is a rather hopeless affair. The way to do it is to get an innovation product.

The CHAIRMAN. I wonder if Mr. Baldwin and Mr. Schmidt agree with that?

Mr. BALDWIN. I do; yes. I agree completely.

Mr. SCHMIDT. Generally, I do also.

The CHAIRMAN. This is a technical question, but one that has not been adequately dealt with.

In the days of the gold standard, we had ultimate adjustment between imports and exports and ultimate equilibrium in balance of payments to gold movements. Gold movements are a bit freer now than they were.

Then it was said even though you do not have gold movements you get adjustments through movement of exchange rates. This would imply free exchange rates and fluctuating exchange rates. What we have instead are pegged exchange rates.

I would like to ask, what automatic method do we have now to equilibrate the claims of the outside world against the United States and the United States against the outside world through the operation, either (*a*) of gold movements, or (*b*) exchange rates?

I once asked an eminent American economist that question, and he said it would take him too long to answer it. So I am still searching for light on this issue.

Who wants to be bold enough to try?

Mr. KINDLEBERGER. I suppose I can offer a few hesitant phrases and see if my colleagues come to my support when I flag.

I would say, sir, the Canadian experience suggests an excellent occasion of one where the fully fluctuating exchange rate is bringing about adjustment from time to time fairly easily without too much friction.

The Bank of Canada does intervene and peg the rate to some extent, but the Canadian economy has been able to stabilize its position vis-a-vis the United States, despite the big shifting pressures which have existed.

The CHAIRMAN. For the sake of the record, would you explain how the fluctuations of the exchange will produce this balance?

Mr. KINDLEBERGER. In theory, if there is an increase in demand for Canadian products, a rise in the value of the Canadian dollar will ensue and means that Canadian exports are more expensive in the United States and people buy fewer of them, and that Canadians buy more imports because American imports are cheaper. These influences bring about equilibrium in the balance of payments, if one leaves out short-run capital movements.

In fact short-run capital movements bring about most of the adjustment, and have done so in the Canadian experience.

The CHAIRMAN. Mr. Baldwin or Mr. Schmidt, wish to make any comment?

Mr. SCHMIDT. Did I understand your question to ask——

The CHAIRMAN. I wanted to have the method by which fluctuating exchange rates would produce ultimate automatic equilibrium.

Mr. SCHMIDT. Professor Kindleberger, in his inimitable way, has already explained it to my satisfaction.

The CHAIRMAN. I would suggest Professor Kindleberger write out his analysis.

Mr. KINDLEBERGER. All right, sir.

I think I want to add one thing, which is a remark made by a British treasury attaché about fluctuating exchange rates. He said any country can adopt a fluctuating exchange rate and get equilibrium, provided it strikes oil at the same time.

The CHAIRMAN. I was trying to urge the Federal Reserve Board to stand for fluctuating exchange rates in its relationship to other countries, and with very dubious success. Suppose you have a frozen exchange rate such as Great Britain has. What method of equilibrium do you have then?

Mr. KINDLEBERGER. A very considerable part of the adjustment mechanism is found in income changes. If a country has an export surplus, this tends to act to raise domestic income, which then spills back over into imports.

If it has a depression, this cuts imports directly. And if an internal income change occurs, there is a limit on how much domestic income can change before the balance of payments runs up danger signals.

The CHAIRMAN. A very practical problem comes out of this because, as you say, American goods are being increasingly exported. The great advantage of superiority in the output which we have normally had is no longer peculiar to the United States. It is being argued that foreign countries, particularly Japan, West Germany, and so forth, with American technique and in some cases American machinery, with low labor costs per hour, are able to produce goods at a lower unit cost than we can, and these goods come into the United States. In some cases there is an outward movement of gold which, if allowed to flow into credit, would increase the price in most countries. But in some cases the gold is impounded in those countries and is not allowed to influence price levels, so that this equilibrating factor is lost.

And in terms of foreign exchange, frozen exchange rates, you do not get the adjustment there that you otherwise would get. Therefore it is argued that the equilibrating forces which formerly operated during the period of the automatic gold standard, no longer prevail, and that therefore we cannot argue, as we used to argue, that ultimately exports and imports equal each other.

We could have a continuing unfavorable balance, so-called unfavorable balance.

What comment do you have to make?

Mr. KINDLEBERGER. I think modern economists reject this view of the matter and say that you must look at income movements. An export surplus is a result of somebody saving something in the system—in other words, to sustain an export surplus you have to have somebody having net savings. An export domestic surplus is net foreign investment which must be offset by net savings.

In the case of the German export surplus, the net savings have been treasury savings, the piling up of tax receipts in the treasury. Adjustment need not come about through gold flows working through the banking system on prices. It can work through the income mechanism.

The CHAIRMAN. To me the German people as such have not increased commensurately the liquid holdings of the German Government. Is that not true?

Mr. KINDLEBERGER. That is true. The increase in income from the export surplus is offset by the increase in taxes which the German Government raises. You could argue that the export surplus is due to these taxes which are not offset by armament expenditures; in other words, the treasury surplus.

I think more and more economists tend to look at the income mechanism as being the equilibrating one, and in this case they would argue that the German export surplus has been deliberately or otherwise offset, and that the balance-of-payments adjustment mechanism is unable to work, because of the governmental savings which offset the balance-of-payments surplus.

The CHAIRMAN. I think it would be a real contribution, when you get the proofs of this discussion, if you were to add some paragraphs on the equilibrating influence of income.

Mr. KINDLEBERGER. I will be pleased to do so.

(The following was subsequently received for the record:)

It is difficult or impossible to furnish an account of the equilibrating mechanism in the balance of payments under fluctuating exchange rates and under the gold standard of the present day which is at the same time concise, complete and commands universal agreement among economists. Omitting a host of qualifications, however, including perhaps primarily that the two systems are not wholly distinct, it is possible to summarize as follows:

Under fluctuating exchange rates, the balance of payments is brought into adjustment by the response to changes in the exchange rate of exports and imports on the one hand; and short-term speculative movements of capital on the other. The proportions can vary. Working through exports and imports, a depreciation of its exchange rate makes a country's exports cheaper abroad, and its imports more expensive at home, with the consequence of stimulating exports and discouraging imports. This result requires that the country's sales abroad are sufficiently stimulated by price decreases, and that its purchases are substantially curtailed by price increases—a condition which economists summarize by saying that the price elasticities of demand must be high enough. Depreciation also tends to make foreigners and residents of the country with foreign assets buy the currency as it cheapens, thus improving the balance of payments on capital account; while appreciation leads to sales of domestic for foreign currency in a converse fashion and stimulates capital outflows. These results require the underlying condition that expectations as to the longrun value of the currency are inelastic, i.e., that people feel that the value of the currency is assured at roughly the current level. If expectations are elastic, people will interpret an initial depreciation as a sign that the currency is beginning a long-run period of decline, and rather than buy it as it falls they will sell short.

A fluctuating exchange rate system of adjustment thus works well—i.e., small changes in the exchange rate produce large adjustments in the balance of payments through exports and imports of goods and services, and short-term capital movements—and, of vital importance—in the right direction, when the elasticities of demand are high and when expectations are firm as to the longrun stability of the exchange rate. This has been the case in Canada, where, however, stability has been achieved more through capital movements than through responses of trade to changes in the exchange rate.

Under the gold standard, or with a fixed exchange rate, economists have modified their early view that the adjustment mechanism started with gold and ran through changes in the money supply to changes in prices. This view, concisely, held that an export surplus produced a gold inflow, which enlarged the money supply (frequently by a multiple of the gold change), and that this in turn, through the workings of the quantity theory of money, raised prices. At higher prices, the value of exports fell (again assuming a substantial reduction of the quantity sold because of the rise in price), while with higher prices in the domestic market, imports increased. In consequence the balance of payments on current account deteriorated. The gold inflow might also have the effect of reducing interest rates and thereby leading to a direct outflow of short-term capital.

This theory was perhaps applicable to the world before World War I when unemployment was limited, and where changes in spending produced changes in prices rather than changes in employment.

Today, most economists would modify the analysis to ascribe more importance to changes in incomes. They believe that as a rule economies have some idle resources, and that this means that an increase in expenditure in the system leads to an increase in output and income before prices rise. The increase in income, however, helps to restore balance in the international accounts even without a price change. If there are sufficient idle resources, an increase in exports financed by a short-term capital outflow, without a gold movement, will lead to a partial or complete adjustment through income changes. An autonomous increase in exports takes up resources into employment and raises income. This increase in income is partly spent on imports, which immediately offsets the expansion in exports, partly saved, and partly spent for domestic products. The part that is saved short circuits the income mechanism. But the part that is respent domestically further increases income, so long as idle resources are available, and in turn is spent on imports, saved, or respent domestically. The lower the proportion saved at each level of spending, the more will the original increase in exports lead to a compensating increase in imports, assuming sufficient idle resources. With no part of the increase in income saved, i.e., a marginal propensity to save of zero, the original increase in exports will raise income until it is entirely offset by new imports.

Even if the marginal propensity to save is high, and the original increase in exports is only partly offset by induced increases in imports at successive rounds of spending, the increase in investment stimulated by lower interest rates resulting from the gold inflow may increase income which spills over into imports.

Much depends upon the state of employment. With idle resources, prices will move but little and the adjustment will be brought about, to the extent that it is complete, by income changes. If there is full employment, so that no substantial increase in real income is possible, the expansion in exports will increase money income and prices, and the adjustment mechanism will operate through the price mechanism, with the income mechanism assisting to the extent that imports are geared to money rather than real income.

The more that a country saves out of a given increase in income, the less effectively will the income mechanism operate to balance international payments. An expansion in exports will then not be fully offset by a comparable expansion in imports but may leave an export surplus in the balance of payments offset by an increase in savings in the domestic economy. Unless the country takes positive steps to expand domestic payments because of the gain in gold and foreign exchange reserves, or to deflate to adjust to a deficit, persistent unequilibrated balances will remain in international payments.

The CHAIRMAN. Mr. Coffin, do you have some questions?

Representative COFFIN. I would like to take a fling at Mr. Schmidt.

I noticed we dismissed this first of our four-point program by saying that this can only be a jawbone attack on stimulating industry, big and small business, to a greater degree of ingenuity. I am thinking or whether or not the Government could be of aid to industry, particularly to smaller businesses, by interpreting what is happening in the world and trying to look ahead to see what kind of future markets will exist—not, maybe, what exists now, but what will exist in 5 or 10 years.

Big companies have their research staffs, and they can foresee demands. Mr. Kindleberger said that a simple example is, if Hong Kong flashlights are impossible to compete with, we ought to see if there is not a new type of flashlight that we could compete with successfully.

I am thinking of whether it would not be a step-up. In various sections in the Department of Commerce we have what we call technical sections of the business and defense services agency in commerce. That is, we have one group on wood products, one on shoes, and so on, and they have a great deal of material. The smaller businesses have no real access to this information. They could compete in the expert field, but they do not have the slightest idea.

I come from a textile area. We have hung on by our feet for a long time. But we see ahead virtually every underdeveloped country going into textile field eventually. So I am sure that our people would be most interested in knowing what we could look forward to. And it is not quite enough to take the Depressed Areas Act and get loans—loans for what? What is an idea that will attract management and also labor?

Therefore, I am just throwing out possibly a wild idea, whether we could not do a better job, an expanded job with agencies we have, or perhaps go into the foreign field, foreign research, product field, marketing, and also put this in some way across to business and industry so that they do know what they face, they do know the fields in which fruitful opportunities lie.

This is more than a jawbone attack. Is it purely visionary or of great merit?

Mr. SCHMIDT. I am hesitant to say it has a great deal of merit, for one reason alone, Mr. Coffin: When the Government makes a mistake it is a whopper because so many people have received particular advice, whereas, if the small businesses were to rely on their trade associations who in turn contract with the many and varied research associations in New York and Washington, we can perhaps avoid the whopper type of error.

I think frankly that you have got at a very valid point, in that something more can be done in this area, and I think American enterprise is waking up to it, because you see these research organizations in New York doing more and more jobs, not necessarily for the largest firms, but the intermediate-sized and perhaps even small ones.

In a way I think the enterprises can handle this problem by themselves.

Representative COFFIN. You made one statement earlier in commenting on the four-point program, when you came to discuss the flexibility-of-resource point. You said we might do something in our antitrust laws.

We hear a great deal of this, and yet just what can we do? To a great extent our competition overseas comes from big companies—that is, to the extent our balanced trade is as good as it is, it is because of the efforts of some of these big companies.

Specifically, how does improvement in antitrust laws develop the kind of resource flexibility that Mr. Baldwin was talking about.

Mr. SCHMIDT. I was thinking of two things, rather inconsistent in appearance. One is that in the general domestic area, the more vigor with which antitrust laws are applied, the more competition we will tend to get—assuming that the laws are applied appropriately, and so on.

The second thing I was thinking of was in the field of international operations. Here I have not thought through to a final position. But I would throw out this thought: That in certain areas of our international operations it seems to me that the antitrust laws have been (1) terribly uncertain, and (2) have retarded the growth of international operations.

I am thinking particularly of the area of exclusive licensing, where some firms seem quite reluctant to go into arrangements which might subject them to antitrust action of some sort. It is hard to say how strong or how important this effect is, but the uncertainty itself can damage the growth of our international receipts.

Representative COFFIN. We may have come to an area in our national economic life where we need to tighten up antitrust laws to achieve maximum competition at home, but a different type of law or a different application is needed for overseas.

Mr. SCHMIDT. I do not want to agree too strongly with that, because my position is not clearly thought out on the international side.

Representative COFFIN. I understand, however, the Swiss and other countries operate with far more freedom than apparently it looks in the short run, with quite a bit of success.

Mr. SCHMIDT. More freedom from their own antitrust, right.

The problem I have is that in principle, by increasing competition in the international sector of the American economy, we ought to be able to do more, in principle. But then I come up against these little facts like exclusive licensing problems which seem to have a different interpretation.

The CHAIRMAN. Senator Javits?

Senator JAVITS. I think I have explored the things I had in mind.

The CHAIRMAN. Congressman Widnall?

Representative WIDNALL. Have any of you thought seriously about how the United States would be affected if Russia went on the gold standard?

Mr. KINDLEBERGER. I can say frankly I have not given thought to this problem.

Representative WIDNALL. Do we have any idea of what gold reserves they have? Is there any check on it at all?

Mr. KINDLEBERGER. No, there is an indirect estimate which is made each year by the Bank for International Settlements in its annual report, which I believe is the most authoritative statement that one has. I am afraid I cannot recall what the last one is. But I think most American economists think that the Russians are a little irrational to continue to mine gold and then ask for credit while they hold their gold unused.

They have used some gold in 1956 and 1957, making some sales in the London market. More recently they have been selling aluminum and benzene, and a few other products instead, holding onto their gold—for what purpose I think nobody has any idea.

Representative WIDNALL. Offhand, what effect do you think it would have on the United States in its position with respect to the rest of the world if they did take such a step?

Mr. KINDLEBERGER. I don't know exactly what you have in mind by "going on the gold standard."

Representative WIDNALL. Would it strengthen their position economically with respect to the rest of the world if they were to go on the gold standard?

Mr. KINDLEBERGER. If they were to sell $6 billion worth of gold and convert it into something else; is that what you mean by going on the gold standard?

Representative WIDNALL. Yes.

Mr. KINDLEBERGER. It depends on what kind of products they would get for it. If these were redundant products which were not selling well in this market and the world thought a little more confidently about the dollar with a little more gold, then you could say it was to our advantage. But I do not think there are such redundant products in any large quantity, and I do not think we would do well if we exchanged useful goods for gold in large amounts.

As it happens, the Soviet sales of gold for commodities in the period of 1956–57 have been very helpful to Europe. This gold came at the time the European deficit was large, and it was a sustaining factor.

Representative WIDNALL. I am very much interested in your suggestion with respect to foreign aid, that we attempt to redistribute a part of the burden to Europe and Japan. Several people have been making that suggestion recently, that the time has come, that they have been aided to the point of economic recovery, and they can participate much more fully than they have in the past.

I feel Congress really should go into this and see if we cannot bring about a wholesome change of that.

That is all.

The CHAIRMAN. Gentlemen, thank you very much for coming. It has been very productive, and we appreciate it very much.

Tomorrow we meet in the same place at 10 o'clock. The subject which is to be discussed is "The Significance of the European Common Market to the American Economy."

Those who will participate in the discussion are Mr. George W. Ball of Washington, D.C., who I believe is the American attorney for the Common Market; Mr. Emile Despres, professor of economics at Williams College; and Tibor Scitovsky, professor of economics at the University of California.

The committee stands in recess until 10 o'clock tomorrow morning.

(Whereupon, at 11:55 a.m., Tuesday, June 30, 1959, the committee recessed, to reconvene at 10 a.m., Wednesday, July 1, 1959.)

# EMPLOYMENT, GROWTH, AND PRICE LEVELS

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**WEDNESDAY, JULY 1, 1959**

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to adjournment, in room P-63, the Capitol, at 10 a.m., Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Sparkman, and Bush; Representatives Boggs, Curtis, and Widnall.

The CHAIRMAN. Gentlemen, we appreciate your coming here to discuss the features of the European Common Market in its relationship to our own problems. I think I should ask Mr. Ball who has worked a great deal on the problems of the Common Market, to lead off, perhaps take 10 or 15 minutes, and then your paper, as such, will be printed in full in the hearings.

## STATEMENT OF GEORGE W. BALL, ATTORNEY, CLEARY, GOTTLIEB, FRIENDLY & BALL, WASHINGTON, D.C.

Mr. BALL. Thank you, Mr. Chairman.

As you know, I have submitted to the committee a long prepared statement. I shall not attempt to read it in full this morning. Instead, I shall try to summarize its basic points and to read excerpts where that may prove useful.

Before beginning my testimony I would like to make two disclaimers.

The first is that while the law firm of which I am a member serves as the legal counsel in the United States for the Commission of the European Economic Community, and also for the High Authority of the European Coal and Steel Community, I am appearing before this committee in a purely private capacity. I have not discussed my testimony with any of my European clients, and any opinions that I state here today represent my personal views as an American citizen.

The second disclaimer I wish to make is that I am not an economist. I say this with no pride, but it is a matter of fact. Therefore, I think I should leave to my two learned colleagues this morning the more esoteric detail of the economic significance of the Common Market for America.

What I shall try to contribute to the studies of this committee—parenthetically, I may say I want to congratulate you, sir, and the members of the committee for giving attention to this subject, because I am persuaded that the Common Market represents an event of very great significance, that it has implications for America of great importance. It is not only proper but I think extremely important that the U.S. Senate and House of Representatives should address their attention to this subject.

The CHAIRMAN. I spent some time a year and a half ago studying the principles of the Common Market, visiting the headquarters of the Coal and Steel Community, which was then in Luxembourg, and I quite agree with you on the essential importance of the subject.

Mr. BALL. What I shall try to contribute this morning are some comments based on random and rather unsystematic observations I have made over the last several years of fairly intimate acquaintance with the development of economic and political unity in Europe. I should like to suggest considerations other than economic that should be given weight in any appraisal made of the benefits and dangers of the Common Market to the United States.

I emphasize the phrase "other than economic" because the Common Market is primarily political in purpose, and its economic objectives, while of great importance, are nevertheless secondary. The men who were responsible for the Treaty of Rome, which serves the Common Market both as a constitution and a code of laws, were inspired primarily by the desire to progress toward political integration, ultimately toward some kind of European federation, some form of a United States of Europe. They recognized very clearly that the Common Market and the two associated communities, the Coal and Steel Community, and the Atomic Energy Community, are simply steps in a process; that they represent by no means a completion of that process.

Nevertheless, emphasis must be given to the political objective of the Common Market. One can say quite categorically that without the political objective there would have been no Common Market and that the six nations which joined in the Treaty of Rome would never have entered into such a revolutionary adjustment of their trade policies if the treaty had contained no political content; if it had been merely a free trade area or a customs union.

In the prepared statement which I submitted to the committee, I set out in some detail the political content of the Common Market Treaty. It provides, over a transition period of 12 to 15 years, for the elimination of all tariffs on trade within the community as well as for the elimination of all barriers to the free movement of goods, services, labor, and capital.

In order to obtain complete mobility of these factors of production, the drafters of the treaty recognized the need for a substantial measure of economic integration, including the development of common economic policies.

I have set forth in my prepared statement a number of the common policies which are to be developed under the treaty. These include common fiscal and monetary policies, a common policy toward cartels and monopolies, and a common commercial policy—policies which together cover a very wide spectrum of Government decision.

I have also described in my statement the institutions which have been established to administer the Common Market. In many ways the institutions are the most important move toward the political objectives which the founders had in mind.

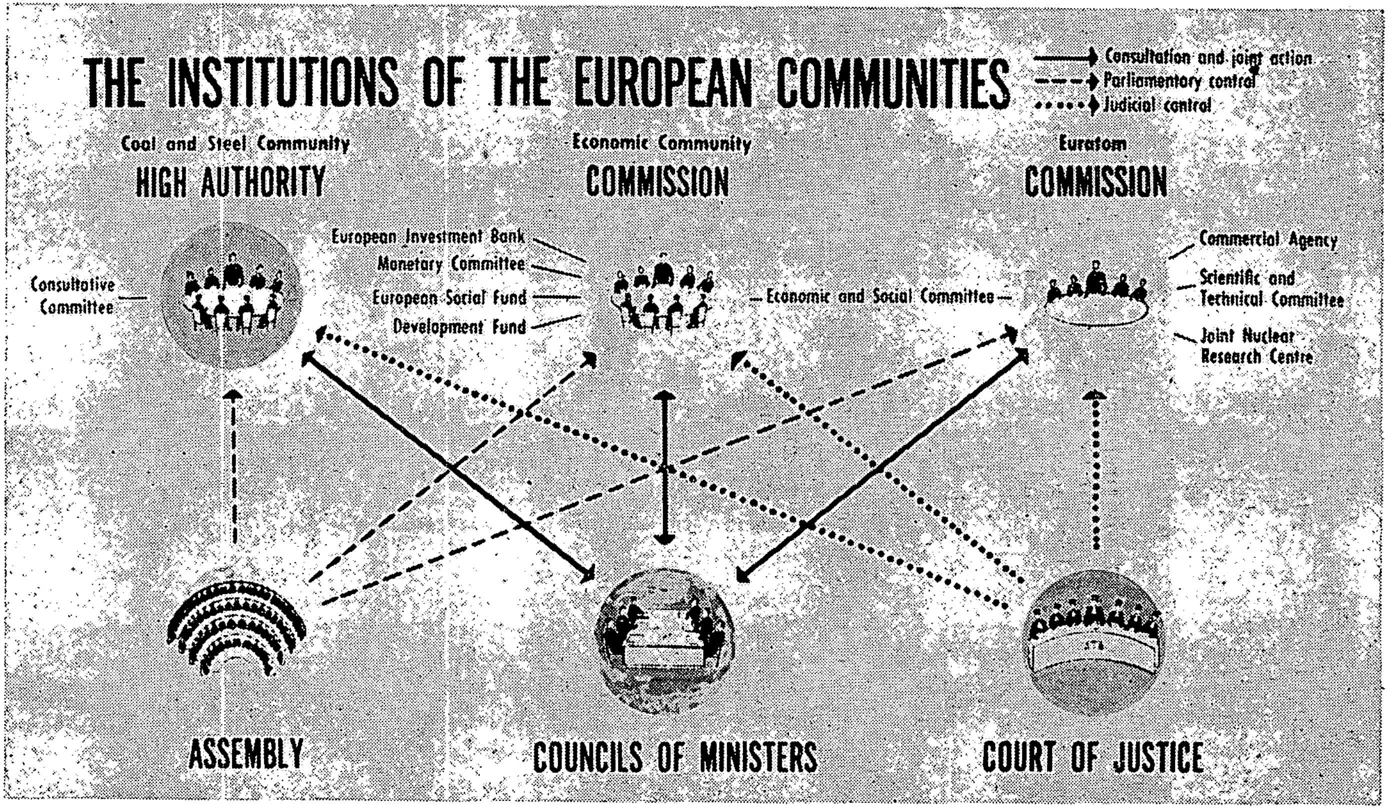
These institutions, which I shall not describe here, in general follow the traditional tripartite division of powers: an executive branch, a judicial branch, and a parliamentary branch. In the view of the men who were most instrumental in bringing about the Treaty of Rome, these institutions may ultimately serve as the nucleus of a United States of Europe.

The CHAIRMAN. Mr. Ball, am I correct in understanding that while the court and the assembly serve not only for the European Economic Community but also for the Coal and Steel Community and the European Atomic Energy Commission, the executive agencies for each of these organizations is different?

Mr. BALL. That is right, sir.

I have a chart (chart I) here which shows this clearly.

CHART I


THE INSTITUTIONS OF THE EUROPEAN COMMUNITIES
Consultation and joint action
Parliamentary control
Judicial control
Coal and Steel Community
HIGH AUTHORITY
Economic Community
COMMISSION
Euratom
COMMISSION
Consultative Committee
European Investment Bank
Monetary Committee
European Social Fund
Development Fund
Economic and Social Committee
Commercial Agency
Scientific and Technical Committee
Joint Nuclear Research Centre
ASSEMBLY
COUNCILS OF MINISTERS
COURT OF JUSTICE

Mr. BALL. Each of the three communities has its own executive. In the case of the Coal and Steel Community it is the High Authority; for the Economic Community, a Commission; for the EURATOM, a Commission.

The CHAIRMAN. Is there a common council for the ministers, or would this be separate for each of the three organizations?

Mr. BALL. It is a council of ministers which is composed of ministers assigned from time to time by the governments of the member states.

For example, in atomic energy the ministers might be different from the ministers who sit on the Council for other purposes.

The CHAIRMAN. What is the relative representation of the three small powers, Belgium, Holland, and Luxembourg, in the three executive commissions?

Mr. BALL. There are two French members, two German members, two Italian members, and one from each of the Benelux countries.

The CHAIRMAN. Are they common to all three organizations?

Mr. BALL. Yes, that allocation is common to all three.

The assumption of the commissions in the High Authority is that these men are Europeans, and they are directed by the treaty not to take instructions from any national state. I may say that from observations that they have developed an extreme independence of view, and think on a communitywide basis.

The significant thing about these institutions is that they are functioning; that they are facing their responsibilities, and that they are growing in stature and acceptance. I suggest that this is a transitional stage for them and that the time may come, although it is mere speculation on my part, when there will be a consolidation of the authority of the three communities.

The CHAIRMAN. Mr. Ball, in your printed statement you emphasize something that struck me as being very significant: That in the assembly the grouping is not by national states, but by party affiliation.

Mr. BALL. That is right, sir. Actually, there is a tendency for some European parliamentarians to think of making a career as European political leaders rather than in terms of their national states.

The CHAIRMAN. So that they would meet as Christian Democrats?

Mr. BALL. Yes, or as Socialists, or according to other party alinements.

The CHAIRMAN. And there are no Communists in the assembly?

Mr. BALL. To my knowledge, there are none. As you know, the Communists have from the beginning opposed the Communities quite vigorously. The parties which are represented sit by party groupings, caucus by party groupings, and in general act along party lines.

Concluding my remarks on the political significance of the community, I would say that, first, the Common Market contemplates not only a pooling of resources but a pooling of policies—the creation of a whole series of common policies covering a wide range of subject matter; second, that the institutions which have been created are gradually acquiring recognition and stature as the governing bodies of the Economic Community. As they acquire this status there is a tendency for them to engage in a more comprehensive range of activity.

Since this committee is primarily concerned with the economic consequences of the Common Market to the United States, I will direct my remarks to that topic.

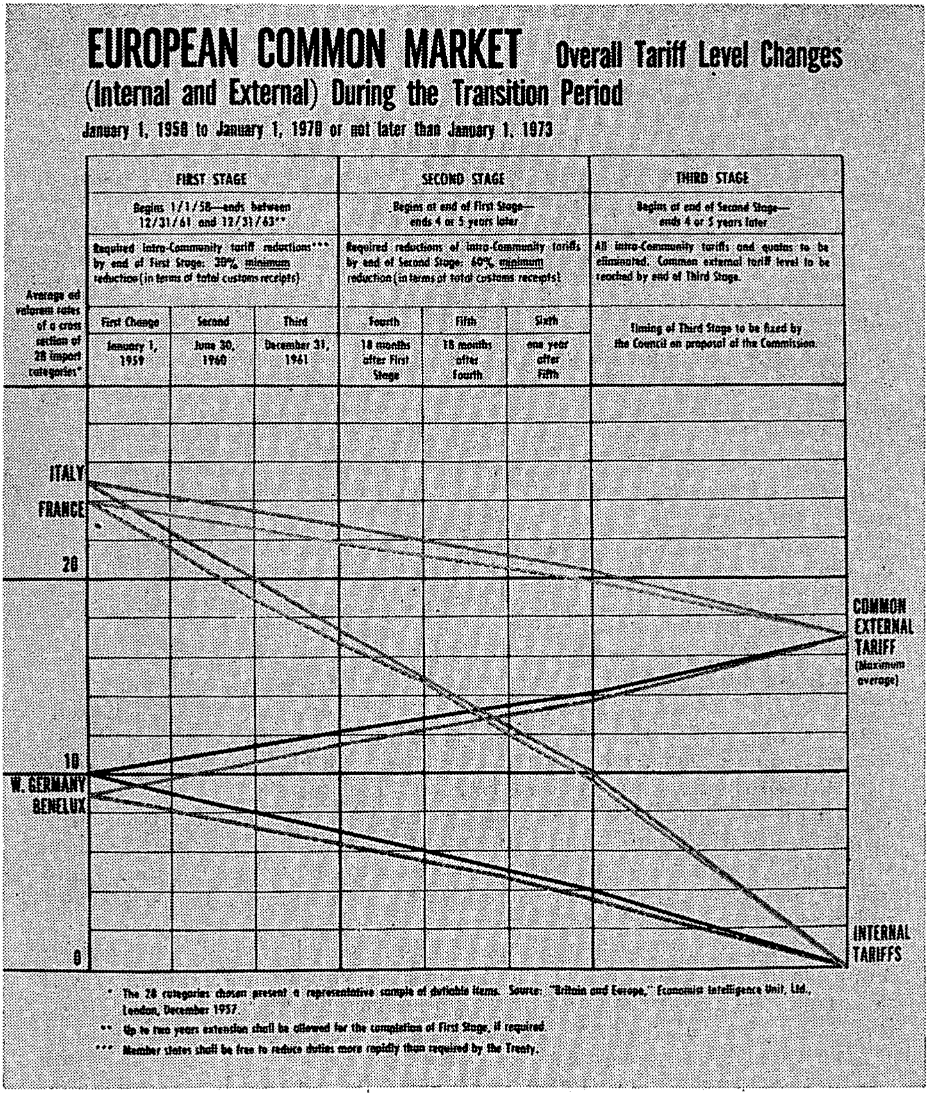
During the past year and a half I have talked with hundreds of businessmen and Government officials on both sides of the Atlantic, in this country, and in the Community. I have formed certain impressions which, although random and unsystematic, nevertheless have led me to some conclusions which I would like to state to the committee.

Any new development of this importance, I suppose, tends to invite a pattern of reaction which in time acquires a validity of its own. There has too often been a tendency, in assessing the effects of the Common Market and in discussing its significance, to repeat the observations of the first men who have addressed themselves to this question.

As a result it has become fashionable, particularly in business circles, to assume that American industry, in exporting to the Common Market, is going to be at a hopeless disadvantage as compared with producers in the Common Market.

The argument is that when the internal tariff, which is the tariff that applies to the movement of goods across national lines within the community, is reduced to zero by the end of the transition period, producers outside the Common Market will be faced with an insuperable obstacle in selling over the common external tariff which will be arrived at by the community (chart II).

CHART II


EUROPEAN COMMON MARKET Overall Tariff Level Changes (Internal and External) During the Transition Period
January 1, 1958 to January 1, 1970 or not later than January 1, 1973
FIRST STAGE
Begins 1/1/58—ends between 12/31/61 and 12/31/63**
Required intra-Community tariff reductions*** by end of First Stage: 30% minimum reduction (in terms of total customs receipts)
SECOND STAGE
Begins at end of First Stage—ends 4 or 5 years later
Required reductions of intra-Community tariffs by end of Second Stage: 60% minimum reduction (in terms of total customs receipts)
THIRD STAGE
Begins at end of Second Stage—ends 4 or 5 years later
All intra-Community tariffs and quotas to be eliminated. Common external tariff level to be reached by end of Third Stage.
Average ad valorem rates of a cross section of 28 import categories*
First Change
January 1, 1959
Second
June 30, 1960
Third
December 31, 1961
Fourth
18 months after First Stage
Fifth
18 months after Fourth
Sixth
one year after Fifth
Timing of Third Stage to be fixed by the Council on proposal of the Commission.
ITALY
FRANCE
20
10
W. GERMANY
BENELUX
0
COMMON EXTERNAL TARIFF
(Maximum average)
INTERNAL TARIFFS
* The 28 categories chosen present a representative sample of dutiable items. Source: "Britain and Europe," Economist Intelligence Unit, Ltd., London, December 1957.
** Up to two years extension shall be allowed for the completion of First Stage, if required.
*** Member states shall be free to reduce duties more rapidly than required by the Treaty.

This chart indicates the dimensions of at least the apparent disadvantage. This chart is based on a composite of some 28 categories of products which was prepared by the economist's intelligence unit. It shows that in order to reach the arithmetic mean—the standard the treaty establishes for the external tariffs—Italian and French tariffs will tend to move downward since these countries have relatively high tariffs while the West German and the Benelux countries' tariffs will move somewhat upward.

The transition period is to last 12 to 15 years but it may be shortened because there are great pressures to shorten it, coming primarily from the business community, interestingly enough, which would like to make its investment plans and its business plans on the basis of a shorter period.

The dimensions of the disadvantage are roughly measured by the converging lines. At the end of the transition period which may be no later, in any event, than 15 years from January 1, 1958, the producers outside the community, whether in the United States or elsewhere, are going to be faced with a common external tariff which, in the case of this composite, amounts to about 17 percent, while their competitors, who have sources of production within the community, will face no tariff at all.

I think that this apparent disadvantage has been overstated and that there has probably been too much concern in America over this question of disadvantage. In my prepared statement I have suggested some of the reasons why there has been this overstatement. The arguments in support of my view are these: First, that while the common external tariff will be higher than that faced by producers within the community, its net effect will be no higher than the tariffs that are presently being faced by American exporters.

Second, that the external tariff can be lowered by negotiation. As you know, under the proposals made by Under Secretary Dillon pursuant to the authority granted by the last Trade Agreements Extension Act, a round of negotiations is presently contemplated. These negotiations are geared to a time schedule which is exactly the time schedule of the first stage of the transition period.

I think that much of the existence or nonexistence of a tariff disadvantage will depend upon the extent to which the administration, with the necessary authority from the Congress, utilizes the maximum of the machinery of reciprocal trade agreements negotiations, in order to bring about a lowering of the external tariffs.

The CHAIRMAN. As I understand what you have said, it is this: That while the absolute tariffs in West Germany and Benelux will be raised, the absolute tariffs in Italy and France will be lowered, ending with a general level no higher than at present.

Mr. BALL. That is right.

The CHAIRMAN. And that even this can be reduced by negotiations under reciprocal trade?

Mr. BALL. That is right, sir.

The third point is that there are good reasons to believe that the Common Market will never have the psychology of a restrictive trading bloc. The treaty is explicit in requiring a liberal commercial policy, and it has been my observations that the men who have the responsibility at the moment for the administration of the treaty are determined to bring about a liberal attitude on the part of the Communiy.

Finally, the Community depends, to a much higher degree than does this country, on trade with the rest of the world. I think this fact in itself will be a compelling reason for them to adopt a liberal policy.

The CHAIRMAN. Do you have this optimism in connection with West Germany? West Germany, as you know, has imposed quotas on our coal, at the very time when it is under no foreign exchange difficulties whatsoever, but indeed is quite proud of the fact that it has several billions of dollars of liquid claims against the United States. Nevertheless, they are imposing very rigid quotas against American coal.

I wonder if your optimism is well founded in connection with West Germany.

Mr. BALL. The situation of the proposed quotas which would be imposed on cold by West Germany fall not under the Treaty of the Common Market, but under the Coal and Steel Community Treaty.

It is quite a different story under the Common Market Treaty because pressures from the Benelux countries for a low tariff policy are are going to be very considerable. Also, I find developing, even in France which has had a tradition of protectionism, a tendency on the part of industry, as it feels more confident of its ability to compete within the Community, to think that it also can compete with the outside world.

I can say more about this when we come to the problem of the free trade area proposals.

Apart from tariffs, of course, the troublesome problem which in many ways has proved a greater impediment to trade in the postwar world, has been quantitative restrictions. Here I think one can display a considerable optimism. The member countries of the Common Market are bound by the GATT rules, which limit the use of quantitative restrictions principally to cases of balance-of-payments difficulties. There has been a very considerable improvement in the balance-of-payments situation of the six countries, and already, as you know, a number of them have taken steps toward fiscal and monetary reforms in order to improve their competitive positions in the Common Market. A trend toward liberalization which I think will continue has also begun.

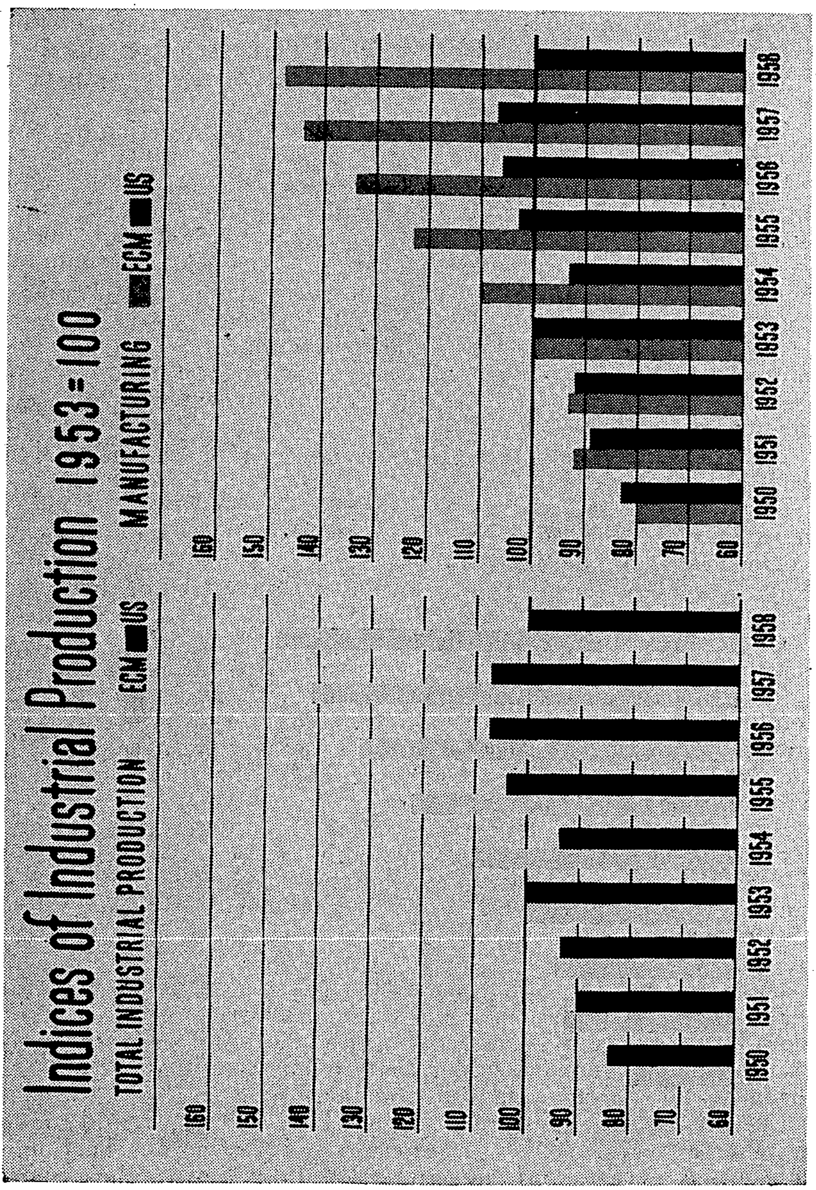
So I expect—and I know this is the view of the people who are responsible at the moment for the administration of the treaty—that the problem of quantitative restrictions will become much less important within a relatively few years, granted a continuing high level of economic activity and continuing trends such as have been shown recently.

I am also convinced that the wave of American direct investment that is going into the Common Market countries has been inspired more by the desire of American businessmen to take advantage of an exciting new economic frontier than by any fear that they will find themselves in a disadvantageous trade position.

Even without the Common Market, U.S. industry would today be showing a very considerable interest in investing in the Common Market. After all, the Common Market did not create the dynamism which has been developing during the past few years in Europe. It is an expression of it, but it should greatly amplify and intensify it.

(Chart III) To illustrate my point, I have another chart which compares the indices of industrial production in the Common Market and the United States. These are based on OEEC figures, using 1953 as 100.

CHART III



Mr. BALL. Taking first total industrial production, the yellow lines suggest a steady, steeply rising curve during the last 8 years for the Common Market countries as against the blue lines, which show very considerable fluctuation for the United States.

The CHAIRMAN. About when did Europe get back to prewar?

Mr. BALL. I would not be quite sure for the six as a whole.

Would you know?

Mr. DESPRES. For the OEEC other than Germany, in industrial production, I would say 1948. Is that not right?

Mr. SCITOVSKY. That is right.

The CHAIRMAN. And Germany?

Mr. DESPRES. Then Germany would perhaps shove the date ahead for the group to around 1950; and in agriculture it was lower.

The CHAIRMAN. So if you take 1950 as the base, you have a base in which Europe, from an industrial standpoint, has recovered from the war, and this means that their relatively greater progress since 1950 over that of the United States, has been real and not merely making up for war arrears?

Mr. BALL. That is right.

The CHAIRMAN. I have been trying to use these figures on the administration, I may say, and I find them particularly unresponsive.

Mr. BALL. These charts, if I may suggest, show quite a bit about Europe but also quite a bit about the United States. What they show about Europe, about the six countries, which I think is significant, is that their economies have been driven by their own internal engine of growth rather than by a response to what has gone on in the United States.

You will recall that we used to say in the immediate postwar years that if the United States caught a cold, Europe would catch pneumonia. But what happened in 1953–54 and 1957–58 would indicate that that is certainly not at all true; that when the United States caught a cold, Europe scarcely had sniffles.

As a partial explanation of these developments, I think it may be useful to look at what might be called the measure of effort that has been made.

(Chart IV.)

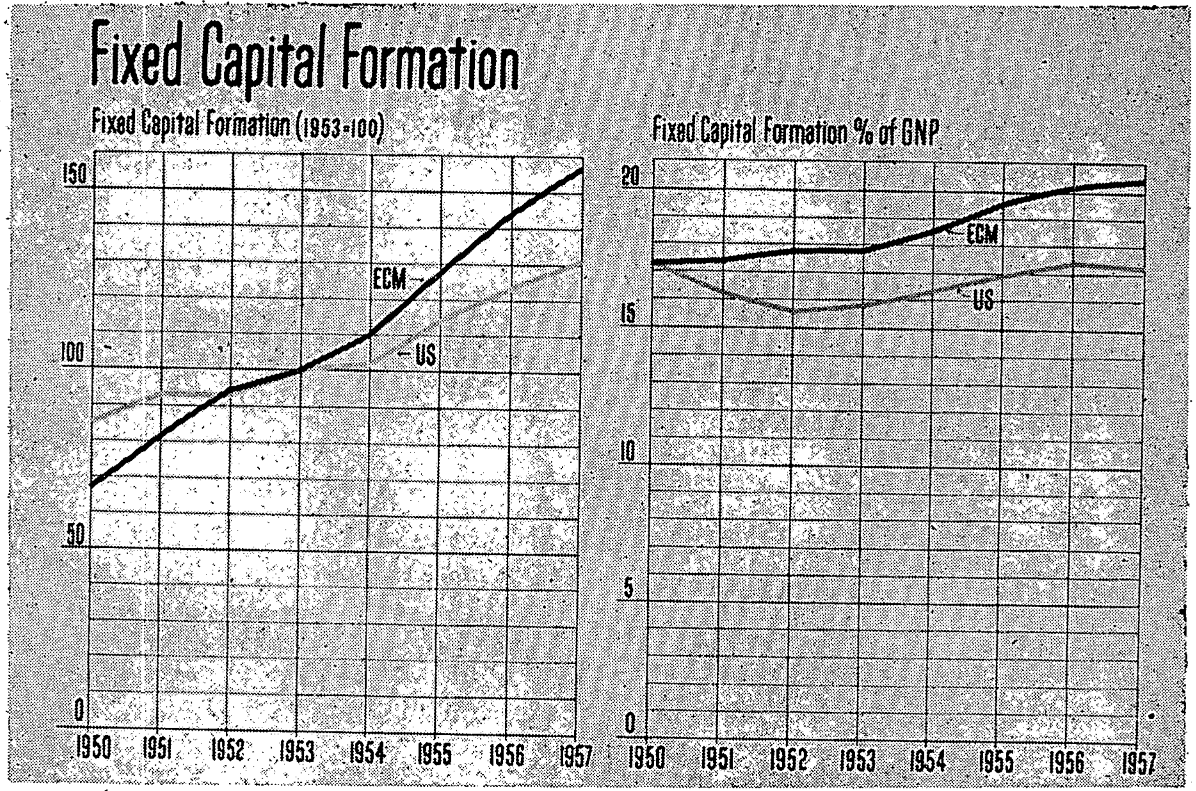
Mr. BALL. The first half of the chart is an index of fixed-capital formation, using 1953 as 100, the other half shows fixed-capital formation as a percentage of gross national product. The black lines show the development for the Common Market countries, and the green lines are for the United States.

As you will notice, taking fixed-capital formation as a percentage of GNP, in 1950 the figures for the Common Market countries and the United States were about the same, which was approximately 17 percent. The United States is still at the 17 percent level and the Community countries are well over 21 percent.

The CHAIRMAN. And you took 1957 as your figure? If 1958 had been taken, the American figure would have declined; would it not?

Mr. BALL. I think so, but comparable 1958 figures for the United States and the Common Market are not yet available. They have just become available for 1957.

CHART IV


Fixed Capital Formation
Fixed Capital Formation (1953=100)
150
100
50
0
ECM
US
1950
1951
1952
1953
1954
1955
1956
1957
Fixed Capital Formation % of GNP
20
15
10
5
0
ECM
US
1950
1951
1952
1953
1954
1955
1956
1957

With this high rate of fixed-capital formation it is scarcely surprising that U.S. investors have been intensely interested in Europe. Even without the Common Market, I think it likely that American direct investments would have been attracted by this investment boom in Europe.

American businessmen in Europe, I am convinced, see not only an opportunity to share in the fruits of a rapidly expanding economy, but also the chance to play a part in the exploitation of a great new mass market. From my firsthand acquaintance with a substantial number of specific cases, I have concluded that the response to the new economic challenge has been the most compelling consideration in persuading corporate managements to seek production sources in Western Europe. Their reaction to the Common Market has been a positive response to a beckoning opportunity, rather than merely a desire to protect entrenched export markets from being swallowed up by local producers who enjoy tariff advantages.

I might add that I suspect that corporate managements have frequently found it useful to emphasize the dangers of staying out of the Common Market more than the benefits that may be derived by going in, in justifying their investment decisions to their boards of directors.

Not only is it likely that American capital will continue to move into the Community, but if present trends continue, there may be a second wave of direct investment, 2, 3, or 4 years from now, of far greater dimensions than the present one—assuming, of course, that the present experience is a profitable one. I know that many American firms are content at the moment merely to establish beachheads of production in the Community. When they have acquired experience and confidence, they will be prepared to put much larger amounts of capital into the expansion of their operations.

Let me turn for a moment, if I may, from the commercial implications of the Common Market to its broader consequences for Western unity.

The fear is frequently expressed—and I am sure we will discuss it at some length this morning—expressed more often perhaps in the OEEC capitals than in Washington—that the Common Market will operate as a divisive force in Europe. This view has been given current particularly since the breakdown of the negotiations over the proposed free trade area which occurred last November.

I think there has been a good deal of confusion in this country as to the nature of the free trade area proposal, and some misconceptions as to why the negotiations failed. The free trade area is—and this is a point I think has to be emphasized very strongly—a purely commercial proposal. It had almost no political content, and the institutions which it proposed were of the most rudimentary kind.

I said a moment ago that the Community would not have come into being if it had not been for its political objectives. I think it may also be said that there would have been no free trade area proposal except as a kind of defensive reflex to the Common Market.

A second point of consequence is that the free trade area is not a customs union. It does not meet the test of a customs union, because it provides for no common external tariff. Each country would be in position to tailor its own external commercial policy to meet its own national advantage.

This, as you know, would have caused a great deal of administrative difficulty. Some arrangement would have been necessary for certificates of origin and for all the complexities which would have resulted.

But apart from this, the refusal to agree to the principle of a common external tariff rendered the proposal unattractive to many of the proponents of the principle of the Common Market. They felt that the free trade area countries would enjoy all the commercial advantages of free access to the Community, while assuming none of the political responsibilities which the Community imposed. This would be particularly true of Great Britain, which under the free trade area proposal would have been the nexus of two great trading areas: A preferential trading area in the Commonwealth and a free trading area in the Common Market.

The implications of this last point can best be seen in relation to projected American investment.

The CHAIRMAN. May I ask you to develop this point.

As I understand it, suppose the Common Market felt that Great Britain wanted to have free access to the industrial markets of Europe, while giving preferential rates to the Commonwealth countries on raw materials.

Mr. BALL. I think it went further than that. The original proposal, as you will recall, would have left agriculture out of the arrangements with the Common Market altogether.

The CHAIRMAN. And, therefore, it could have been used to have barred the French agricultural products from the British market?

Mr. BALL. That is right. And as you know, the British agricultural lobby is a very important one.

But apart from that, it would have preserved for the United Kingdom free access for its industrial production to the Commonwealth countries, which would not have been available to the Common Market, and at the same time it would have had the Common Market totally available to its own industry.

Just to give a single example of the effects of this, let us take the case of the American company considering the possibilities of investment in Europe.

I can say quite categorically to the committee, based on my own experience, that a very large percentage of American companies considering direct investment in Europe would have invested in the United Kingdom and would have had the best of all possible worlds. They would have had preferential access to the Commonwealth and free access to the Common Market. This was something of which the Common Market countries were very much aware.

As it is, the tendency is greatly the other way. American companies are tending to invest in the Community itself and to bypass the OEEC countries outside of the Community.

The CHAIRMAN. In order to make the record clear, is it not true the Common Market offered to Great Britain the chance of becoming a full member?

Mr. BALL. Great Britain could have joined at any time during the negotiations—the door was completely open. It refused to do so for political reasons which it felt outweighed the commercial advantages.

The CHAIRMAN. I have no wish to create an international incident or some ill will between our allies, but I always believe in having the cards on the table.

Is it not true that Great Britain on the whole has been opposed to the economic and political integration of Western Europe?

Mr. BALL. I would say that certainly, so far as its own participation is concerned, it has felt it could only participate in the very limited form of cooperation which involved no derogation of its national sovereignty. I think it was Prof. Andre Siegfried who once said that the United Kingdom was a ship moored in European waters but always ready to sail away at a moment's notice.

For historic reasons I think that the British have not made the great national decision to become a part of Europe. They are faced with that now.

The CHAIRMAN. You mean they have made the decision?

Mr. BALL. I think they have not made the decision—not yet—to become a part of Europe. They still think of themselves as the trading center of a great commonwealth of nations.

The CHAIRMAN. Have they made a decision not to become a part of it?

Mr. BALL. I think that up to this point they have not taken any action which would make them a part of Europe. I think that the free trade area would not have done that, in the sense that it would have involved no political commitments on the part of the British.

I might say I am sympathetic to the problem which Great Britain faces, and I would not want to suggest otherwise to the committee. It has historic reasons for not wanting to make a decision to become a part of Europe. It has commitments outside of the framewark of Europe of a very important kind.

But I do suggest in my statement that the greatest pressure on the United Kingdom at the moment to have a closer relationship with the Common Market is the pressure that is created not by the fear of trade disadvantage in the future, but by the present serious danger which they see in losing the flow of investment capital which is going into the Common Market.

The CHAIRMAN. You mean from the United States?

Mr. BALL. From the United States primarily, yes.

This means to them that the Common Market industries or Common Market competitors are getting stronger by the infusions of American capital and technical assistance, while they are not participating in that strengthening process.

In addition, I have frequently heard in London that a considerable number of producers in such cities as Manchester or Liverpool are being notified that their outlets on the Continent have been preempted by American firms that have made proposals to put capital into distributive ventures. Consequently they see their old trade alliances and trade arrangements being eliminated.

As a matter of fact, there is a beginning of a tendency for British firms now to establish sources of production or partnership arrangements in the Common Market.

This fear of loss of new investment has been the biggest incentive for the British to bring about the meeting which just occurred in Stockholm. This meeting developed the project for a grouping of the seven in a free trade area arrangement.

This grouping of the seven may prove valuable to the extent that it facilitates trade among the seven members, but if it remains simply a preferential trading area on the periphery of the Common Market, I think it could result in some distortion of normal trade lines. Over a period of time it might make the problem of a merger more difficult.

I am not too alarmed about the divisive implications, but at the same time I think that this is something toward which this country cannot take a completely passive attitude. After all, the countries of the OEEC outside the Common Market are faced with somewhat the same problem with respect to the Common Market that we are.

One can say that the difference is that we have accepted the idea that European unification is good for our national interests, while the seven have not. But I think that is somewhat of an oversimplification. After all, the nonmember European nations are faced with a critical national decision—whether or not to participate in an effort of European unification—while we have always considered ourselves geographically excluded from this problem of choice.

In any event, I think the time has come, given this apparent deadlock in the situation in Europe, when we might think in terms of a new American initiative, an initiative aimed at encouraging the progress which has been made toward unification in Europe, while avoiding any divisive consequences that might flow from an extension of the present situation.

I will not try to suggest to this committee the precise detail which our lines of policy might take, but I think that we might do well to propose some kind of machinery for systematic consultation, at least, between the United States and Canada—North America together—the Common Market, speaking as a unit, which I think it is probably now prepared to do, the United Kingdom and the other countries of the Organization for European Economic Cooperation. This grouping constitutes the major industrialized nations of the Western World. They have a number of problems which they could advantageously face together. They could discuss over a continued period and on a systematic basis problems which, while they are economic in character, nevertheless have political dimensions as well.

For example, when Professor Hallstein, the president of the Commission of the European Economic Community, was in Washington 2 or 3 weeks ago he made a number of public references to the interest of the Community in participating in aiding the underdeveloped countries. I think this grouping of nations that I have suggested might collaborate on this problem as well as on the associated and very pressing problem of the stabilization of raw material prices, since very often the aid programs are rendered unimportant or nugatory by the effect of fluctuations in raw material prices in the world market.

The group might also consult to some extent on problems of international liquidity and on a whole series of problems of this sort; and, finally, on reaching a general agreement on major aspects of commercial policy. I am not suggesting that this be done in derogation of GATT. I think whatever agreement is worked out should be translated into action through the GATT machinery on a multilateral basis. But I do have a feeling that if this group of the major industrialized powers were to come to grips with some of the most difficult commercial policy questions, within an area where intense conversation was possible, where the number of representatives of powers involved was relatively small, some real progress could be made, and that on problems presented of a kind such as the difficulties of the 6 and 7, progress could be made toward a reconciliation.

In making this proposal, I do not want to be understood in any way as suggesting a cabal of the industrialized nations against the underdeveloped nations; but, on the contrary, I believe that a mechanism of this sort might be the means for the extension and better distribution of the responsibilities of the industrialized nations to increase the standard of living in the less developed areas.

The CHAIRMAN. An objection, Mr. Ball, was made by three of the four witnesses yesterday, and when I went out on the floor of the Senate in the late afternoon, I found that the preamble of the mutual aid bill had appeared advocating this very thing.

Mr. BALL. I claim no originality for this suggestion.

The CHAIRMAN. No; I am not trying to take any originality from you.

Mr. BALL. This kind of proposal I think is one that is indicated by the times, and I am sure that a great many people in Europe as well as the United States would welcome an initiative of this kind from the U.S. Government.

The CHAIRMAN. Do you have any questions, Mr. Widnall?

Mr. WIDNALL. No; I don't have any questions.

The CHAIRMAN. Congressman Boggs is a great authority in Congress on the Common Market, having produced the most excellent report or series of papers on the subject that I think has appeared in any language.

Representative BOGGS. Thank you, Mr. Chairman. I would not dare ask this man any questions. He knows too much about it.

The CHAIRMAN. Your written statement will be inserted in the record at this point.

(The statement referred to is as follows:)

### STATEMENT OF GEORGE W. BALL ON THE SIGNIFICANCE OF THE EUROPEAN COMMON MARKET TO THE AMERICAN ECONOMY

The law firm of which I am a member serves as legal counsel in the United States for the Commission of the European Economic Community. It is also the U.S. legal adviser to the High Authority of the European Coal and Steel Community.

I want to make it quite clear, however, that I appear before this committee in a purely personal capacity. I have not discussed my testimony with any of my European clients, and what I say to you today represents merely the private views of an American citizen.

Unlike my distinguished friends who are testifying today, I am not an economist. I shall, therefore, leave to them the major burden of discussing the economic significance of the European Common Market to America. I believe I can contribute most effectively to the studies of this committee by trying to put the Common Market in a political perspective and by suggesting some considerations other than economic that should be given weight in an appraisal of the benefits and dangers of the Common Market to the United States.

The point I wish first to emphasize is that the Common Market is political in purpose. Its economic objectives, while important, are nonetheless secondary. The gifted and dedicated men who were responsible for the Treaty of Rome, which serves the Common Market both as a constitution and a code of laws, were inspired by the desire to make progress toward political integration—ultimately toward European federation. For them economic integration was the means to a political end.

One can say categorically that without this political end there would be no Common Market. The six nations which have joined in the Treaty of Rome would never have entered into such a revolutionary readjustment of their trade policies if the treaty had contained no fundamental political content, if it had been merely a free trade area or a customs union.

### POLITICAL CONTENT OF THE COMMON MARKET

The political character of the Common Market becomes apparent when one examines the Treaty of Rome. Under its provisions the member states, over a transition period of 12 to 15 years, will eliminate not only tariffs but all other barriers to the free movement of goods, services, labor and capital throughout the Economic Community. But the treaty recognizes that complete mobility of these factors of production can be achieved only with a substantial measure of integration, including the development of common economic policies.

For example, the member nations of the Community agree—

(1) To work toward a common fiscal and monetary policy, and to provide mutual aid in the event a member country encounters balance-of-payments difficulties;

(2) To take measures to equalize the conditions of labor at an increasingly high level and to apply the principle of equal pay for equal work by men and women;

(3) To establish common rules and regulations governing cartels and monopolies;

(4) To adopt a common agricultural policy; and

(5) To undertake a common commercial policy—according to a precise timetable and with specific goals—including a common tariff governing imports from the rest of the world.

The treaty establishes a European investment bank to supply capital for modernization, the improvement of production, and development of the retarded areas of the Community. It provides a social fund to relieve the hardships to workers from the temporary disruptions implicit in trade liberalization. It provides also for the permanent linkage to the Common Market of those overseas territories especially tied to one or another of the member States, unless those territories decide otherwise, and establishes a development fund for those territories.

One can say, in other words, that the treaty contemplates not only a pooling of resources but a pooling of policies for the six nations acting as a unit. Those policies cover a wide spectrum of governmental decision.

### INSTITUTIONS OF THE COMMUNITY

But the essential political character of the Community is most evident from the institutions created to oversee the development of common policies and to administer the treaty. Those institutions, which reflect the familiar tripartite division of powers, hopefully represent to many Europeans the evolutionary institutions of a federal Europe.

The executive power of the government of the Community is shared by a Commission and a Council of Ministers.

The Commission, which has the day-to-day responsibility for the administration of the Community, is composed of "Europeans"—men appointed for fixed terms who are required by the treaty to act for the Community as a whole and not to seek or accept instructions from any national state.

The Council of Ministers, which must concur in many of the decisions of the Commission, consists of ministers representing the governments of the member states. During the early part of the transition period the Council of Ministers may act only by unanimity; as the transition period progresses, it may make many of its decisions by majority vote.

The judicial power is vested in a Court, which serves as the supreme judicial body with final jurisdiction to decide all legal controversies arising under the treaty. It may hand down decisions binding not only on enterprises but even on member states.

The Court is building up a body of decisional law which will constitute a kind of European jurisprudence. It now has on its docket over 60 pending cases.

The parliamentary power is vested in an Assembly. For the time being members of the Assembly are elected by the parliaments of the national states from among their own members. The Commission, however, has been entrusted by the treaty with the task of developing a plan for the direct election of the Assembly by the peoples of the member states.

The Assembly has many of the attributes of a European Parliament. While it does not have the power to pass legislation, it regularly reviews the work of the Commission and by vote of censure can require the resignation of the Commission as a body. It is significant that in the Assembly the seating is by party groupings and not by national delegations.

The Court and the Assembly serve not only the European Economic Community but also the two other Communities which have been established by the six member nations—the European Coal and Steel Community and the European Atomic Energy Commission.

The drafters of the Treaty of Rome approached political integration through economic means. Being pragmatic men, they felt that by integrating the economies of the six member states through the creation of a vast market of 170 million people—about the same as the population of the United States—they could not only give momentum to the drive toward federation but create conditions in which solutions along Federal lines were compelled by an inexorable logic.

### REPERCUSSIONS ON THE AMERICAN ECONOMY

For a group of the greatest industrial and trading nations of the world to commit themselves to an undertaking of such dimensions must necessarily have repercussions outside the Community itself. Certainly it will have consequences for American business and the American economy—and, as I shall point out later, for American foreign policy as well.

While, as I have said, I am diffident about intruding in the esoteric area of economic prediction, I would like to put forward some suggestions based on random and unsystematic observations. During the past year and a half, I have talked with literally hundreds of businessmen and Government officials both in the United States and the Common Market nations, and from these discussions I have formed certain impressions which may be of use to this committee.

It is a truism, I suppose, that new developments tend to invite patterns of reaction that in a short time acquire a validity of their own. In approaching the Common Market and in assessing its significance for America, there is the temptation to accept the observations of the first men who happened to have addressed themselves to this question.

It has, for example, become fashionable, particularly in business circles, to assume that American industry will be at a hopeless disadvantage in exporting to the Common Market.

The argument is that when the internal tariff—by which I mean the tariff applicable to the movement of goods across national boundaries within the Community—is reduced to zero by the end of the transition period, producers outside the Common Market will be faced with an insuperable obstacle in selling goods over the common external tariff.

### THE EXTENT OF TRADE DISADVANTAGE

I believe that there has been too much concern in America over the alleged disadvantage that will be suffered by American producers. In some instances concentration on this aspect of the Common Market has lead to inadequate and inaccurate analysis.

There are several reasons for this conclusion.

First, while the common external tariff will be higher than the progressively diminishing internal tariff faced by producers within the member countries, in its net effect it will be no higher than the tariffs which American producers now face in selling in the Community countries. The Common Market complies with the provisions of GATT, which requires that in establishing a customs union the external tariff cannot be more restrictive in effect than the tariffs of the individual countries comprising that customs union.

Second, even this tariff level cannot be taken as fixed. The external tariff is subject to negotiation. What is now called in Europe the Dillon proposal for tariff negotiations under GATT will begin in the fall of 1960. These negotiations, as you know, will be undertaken under the authority granted the President by the Trade Agreements Extension Act of 1958, which was designed quite explicitly as a mechanism for reducing the external tariff of the Common Market.

The willingness of our Government to employ the machinery of trade agreement negotiations without hobbling itself by an undue preoccupation with peril points and escape clauses—in the long run perhaps, the extent to which the Congress permits it to do so—will be critical in determining the character of the external tariff of the Common Market.

I cannot emphasize this point too much.

Third, I am convinced that in trade policy the basic thrust of the Common Market must inevitably be liberal. The commitment to a liberal policy is made explicit by the treaty. This commitment is happily in accord with the views, as I have observed them, of the officials who have the responsibility for the administration of the Common Market.

Most important of all, the Common Market will be compelled to follow a liberal policy out of economic necessity since the Community as a whole is dependent to a very high degree on world trade—to a far greater degree, as a matter of fact, than is the United States.

My fourth reason for minimizing the trade disadvantage to American producers is that I would expect to see the progressive enlargement and ultimate elimination of quantitative restrictions with respect to external trade. I need not remind the committee that since the war quantitative restrictions have been more formidable impediments to trade than tariffs.

Just as in the case of tariffs, the commitments under GATT will govern the regime of quotas that may be applied against outside trade; and the GATT rules call for the limited use of such quotas, principally in case of balance-of-payments difficulties. As the committee knows, there have recently been important moves toward the liberalization of quotas on dollar imports in line with the improved exchange position of individual member countries. If present trends continue I am sure we shall see more such moves in the near future.

On the basis of these observations, I think it can be said with some confidence that through the first stage of the transition of the Common Market which ends in 1962, the commercial policy of the Common Market will be more liberal than the commercial policies of the individual countries before the Common Market came into existence.

While long-range predictions are hazardous, I see every reason why this trend toward liberalization should continue into the future. If, as may be expected, the economies of the six are strengthened by the Common Market, their ability to undertake further liberalization measures will be equally strengthened. At the same time, pressures for protectionism should diminish; as European firms reorganize their production to respond to the intensified competition of the Common Market, they will acquire the ability and confidence to face competition from the rest of the world.

Given the continuance of favorable world economic conditions, the Common Market countries should have no need to resort to import quotas for balance-of-payments reasons. The internal forces within the Common Market inducing the improvement of fiscal and monetary policies support this view. For example, certain of the recent fiscal and monetary reforms of Community governments directed at improving their foreign exchange position have been inspired by the need to face the new realities of the Common Market.

## U.S. INVESTMENT IN THE COMMON MARKET

So far the most spectacular effect on American business associated with the Common Market has been an acceleration of direct investment in the Community by American firms. This export of American capital and know-how is frequently explained on the ground that American companies are seeking sources of production in Europe because they fear they will be unable to export over the external tariff into the Common Market in competition with local producers.

I am persuladed that this is at best a partial, and in many cases a wholly inaccurate, explanation of the reason why American businesses are invading the Community. Even without the Common Market, some trend in this direction would likely have occurred at this time.

The Common Market did not create the dynamism which has been gaining force in Europe, particularly over the past 10 years. It is in a sense an expression of that dynamism. But it should greatly amplify and intensify it.

During the present decade industrial production in the Community has been driven by its own internal engine of growth. This is apparent if one compares the indexes of industrial production in the Common Market and the United States during the period 1950–58.

While the American production has been marked by two recessions and an only moderate total increase, production in the Common Market has risen sharply and steadily during this entire period.

At least a partial explanation of this phenomenon can be found in the fact that the percentage of gross national product devoted to fixed capital formation has been not only higher for the Community than for the United States, but has been increasing at a faster pace. While the figure for both areas in 1950 stood at approximately 17 percent, by 1957 the Community percentage had risen to over 21 percent while that of the United States had not increased. It is scarcely surprising that U.S. capital has been attracted to Europe by such an investment boom.

American businessmen see in Western Europe not only an opportunity to share the fruits of an expanding economy but also the chance to play a part in the exploitation of a great new mass market—a kind of new economic frontier being created by the Community. I am convinced from firsthand acquaintance with a substantial number of specific cases that this response to a new economic challenge has been the most compelling consideration in persuading corporate managements to seek production sources in Western Europe. Their reaction to the Common Market has been a positive response to a beckoning opportunity rather than the mere desire to protect entrenched export markets from being swallowed up by local producers that enjoy a tariff advantage.

Parenthetically, however, I suspect that corporate managements have frequently found it useful to emphasize the dangers of staying out of the Common Market, rather than the opportunities of getting in, in order to justify investment decisions to their boards of directors.

Not only is it likely that American capital will continue to move to the Community, but I think it probable that if present trends continue there may be a second wave of investment 2, 3, or 4 years from now, of far greater dimensions than the present one. Many American firms today are content merely to establish beachheads of production in the Community. When they have acquired experience, when they have gained confidence—provided, as I think it probable, that they have made money in the process—they will be prepared to put much larger amounts of capital into the expansion of their operations.

WILL THE COMMON MARKET DIVIDE EUROPE?

Let me turn for a moment from the commercial implications of the Common Market to its broader consequences for the unity of the Western World. The fear is frequently expressed—more often in the OEEC capitals than in Washington—that the Common Market will operate as a divisive force in Europe. This view has been given currency particularly since the breakdown of the negotiations last November looking toward the creation of a free trade area that would extend the trade arrangements of the Common Market to the whole area of the 17 OEEC countries.

There has, I think, been confusion in America as to the nature of the free trade area proposal and some misconceptions as to why the negotiations failed.

The free trade area—and this point cannot be emphasized too strongly—was a purely commercial proposal. It had almost no political content; it provided for only the most rudimentary institutional arrangements. I said a moment ago that the Comunity would not have come into being except for the political objectives which inspired it; it is equally true that the free trade area proposal would never have been put forward except as a defensive reaction to the Common Market.

A second point of consequence, not unrelated to the first, is that the free trade area did not even meet the test of a customs union since it did not require the member nations to adopt a common external tariff. Each would have been free to tailor its own commercial policy toward the outside world so as to gain the maximum national advantage.

This failure to require a common external tariff was important. It raised formidable technical and administrative problems since elaborate measures would have been necessary to prevent goods from entering the Common Market by transshipment through countries with the lowest external tariffs. But apart for this, the refusal to agree to the principle of a common external tariff rendered the proposal unattractive to many of the most ardent supporters of the Common Market. They felt that the free trade area countries would enjoy all the commercial advantages of free access to the Community while shunning the political responsibilities which the Community imposed. This would be particularly true of Great Britain which, under the free trade area proposal would serve as the nexus of two trading systems, the British Commonwealth and the free trade area.

The implications of this last point can be best seen in relation to the investment policies of American companies. There is no doubt that had the free trade area been accepted by the Common Market countries in the form in which it was proposed by the United Kingdom, a large share of American direct investment now flowing into the Common Market would have gone to the United Kingdom.

Producers in the United Kingdom would have enjoyed the best of both worlds—preferential access to the Commonwealth and free access to the free trade area. While it is true that for many companies this would have been only a marginal consideration, nonetheless, all other things being equal, I am certain that in many cases it would have tipped the balance in the choice of location.

As soon as the failure of the free trade area negotiations became probable more and more American companies elected to concentrate investment in the Community. This trend is becoming daily more evident. It is the source of increasing concern for nonmember European countries which find themselves bypassed.

For such countries the impact of commercial disadvantage in selling to the Common Market consumers is prospective rather than immediate, but the loss of investment capital appears as a real and present danger. They are confronted with the disturbing spectacle of their Common Market competitors growing progressively stronger with capital infusions from the United States. To compound their concern, manufacturers in Manchester and Liverpool are receiving letters from sales agents and distributors on the Continent with whom they have long enjoyed commercial relations, containing the melancholy advice that those relations are being terminated in favor of American companies which are prepared to invest capital or make other attractive concessions.

These are the considerations which have, I believe, proved the most compelling incentive for the recent meeting at Stockholm and the decision of seven OEEC nations outside the Common Market to form a free trade area among themselves. These countries are Britain, Austria, Switzerland, and the three Scandinavian countries, and Portugal. The precise form of the Stockholm arrangement is not yet known and its larger consequences are even less clear. No doubt it is in part a defensive response to the Common Market and in part a serious effort to build a bridge to a larger European trading scheme.

It may prove valuable to the extent that it facilitates trade among its members, but if it remains as simply an additional preferential trading area on the periphery of the Common Market, it could result in an artificial distortion of the flow of trade without contributing to the resolution of the basic problem of European economic integration.

I think, however, that we would do well not to be too alarmed by its divisive implications. Nor should we be unsympathetic with the dilemma of the European countries outside the Common Market. For what seem to them good and sufficient reasons—which differ from one nation to another—they have felt unwilling or unable to assume the political obligations of the Treaty of Rome. Yet, at the same time, the coming into being of the Common Market presents them with a serious problem—the same problem it poses for the United States, although in a more intense degree.

We can say that the difference between our attitude toward the Common Market and that of the nonmember European nations is that we have accepted the proposition that European unification is in our national interest while they have not. But we cannot be too smug in making this assertion. After all, the nonmember European nations are faced with a critical national decision—whether or not to participate in an effort of European unification—while we have always considered ourselves geographically excluded from this problem of choice.

NEED FOR AN AMERICAN INITIATIVE

Up to this point, we in the United States have watched the evolution of European political and economic integration as a kind of benevolent Uncle Sam, speaking encouraging words but resisting the temptation to suggest the precise course which this evolution might take. I think that on balance this has been a wise course of action. However, we may well have reached the point where a new American initiative is called for—an initiative aimed at preserving and encouraging the progress toward political and economic integration which has so far been achieved, while avoiding the divisive consequences that could affect a range of considerations much broader than commercial policy.

It is not my purpose here to set forth in detail what I think the precise lines of our national policy should be. But the time may be ripe when we should propose some systematic arrangement for cooperation between the United States, Canada, the Common Market (speaking as a new entity in the Western World), the United Kingdom, and other members of the OEEC.

Together these constitute the major industrialized areas of the Western World, and there are a number of problems which this group of nations could profitably discuss over a continued period—problems economic in character but with political dimensions.

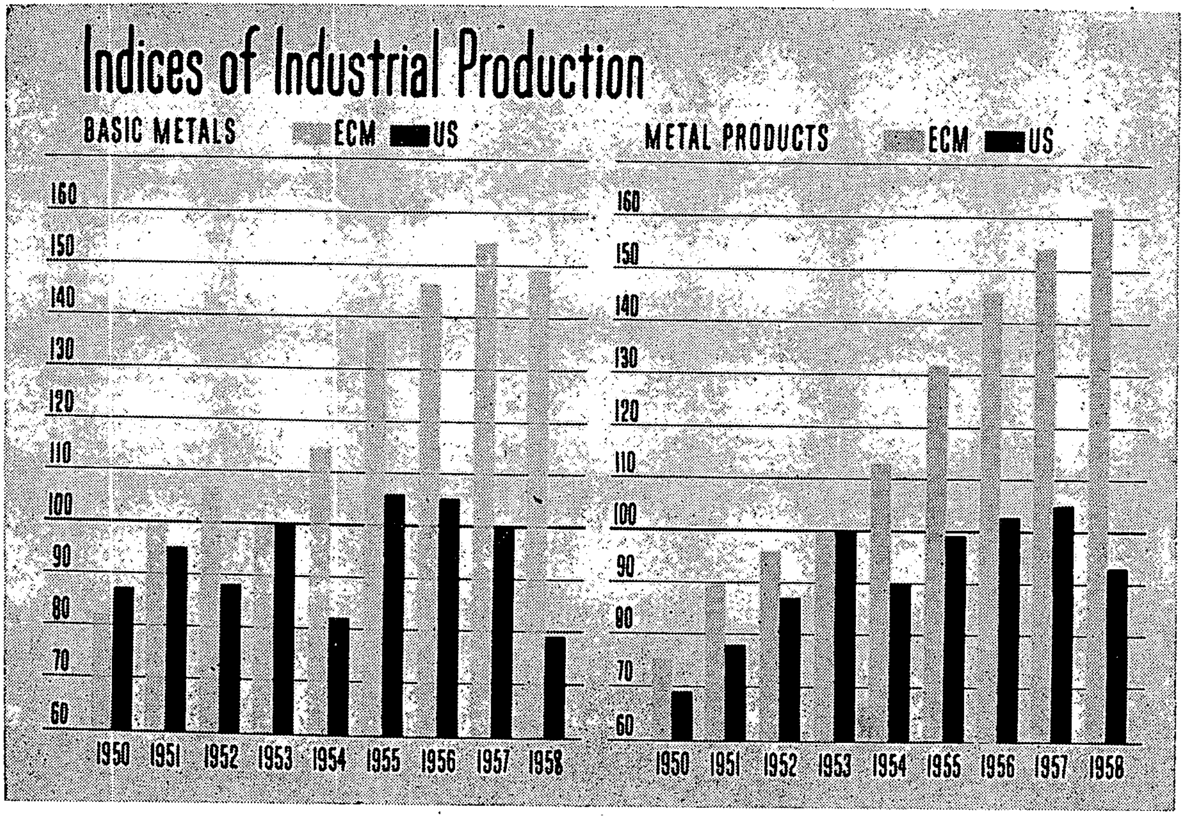
For example, when Professor Hallstein, the President of the Commission of the European Economic Community, was in Washington a fortnight ago, he made several public references to the interest of the Community in providing aid to the underdeveloped countries. I think the group of nations I have mentioned might well collaborate on this problem as well as on the associated problem of stabilizing world markets for primary commodities. The members of the group might usefully consult also on the questions of international liquidity and, finally, might seek greater agreement for an increasing liberalization in commercial policy.

I do not mean that we should propose the creation of a free trade area for the Atlantic community. I do have the feeling, however, that by continued and systematic consultation among the nations and groups of nations I have listed we could settle many of the tough commercial policy questions that are disturbing us, leaving to GATT their implementation in the context of a multilateral system.

In making this proposal I would not wish to be understood, by any stretch of the imagination, as suggesting a concert of the industrialized nations against the less developed areas. Rather I would see it as a mechanism whereby the industrialized nations can arrive at an extension and better distribution of their responsibilities to increase the standard of living and well-being all over the world.

It is ancient wisdom that we are always prepared to fight the next war with the weapons of the last. For a long time we have made our economic decisions within the framework of economic institutions and policies that were for the most part developed during a postwar period when rehabilitation and recovery were the prime need of the Western World. Today we are faced with a wholly different set of conditions and preoccupations. An approach responsive to modern economic realities might well be welcomed.

(The following are additional charts submitted by Mr. Ball for the record:)


Indices of Industrial Production
BASIC METALS
ECM
US
METAL PRODUCTS
ECM
US
160
150
140
130
120
110
100
90
80
70
60
1950
1951
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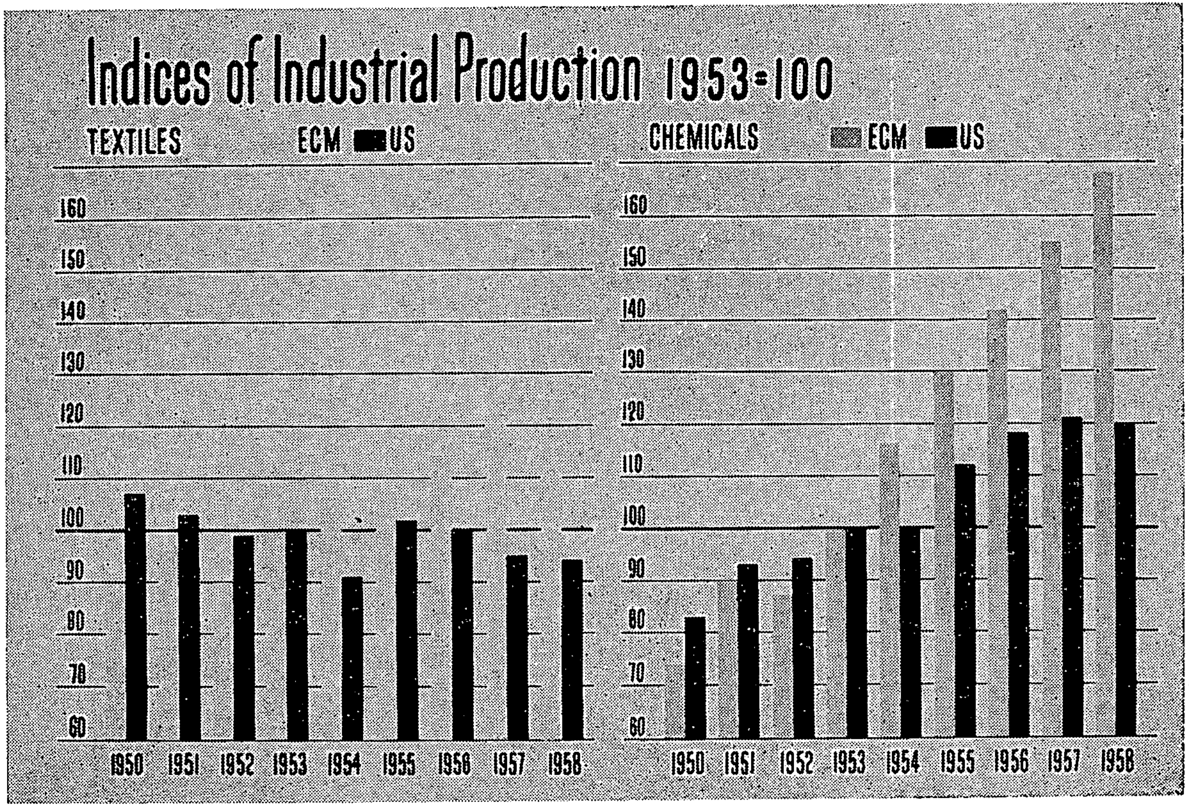
1957
1958


Indices of Industrial Production 1953=100
TEXTILES
ECM
US
CHEMICALS
ECM
US
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150
140
130
120
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100
90
80
70
60
1950
1951
1952
1953
1954
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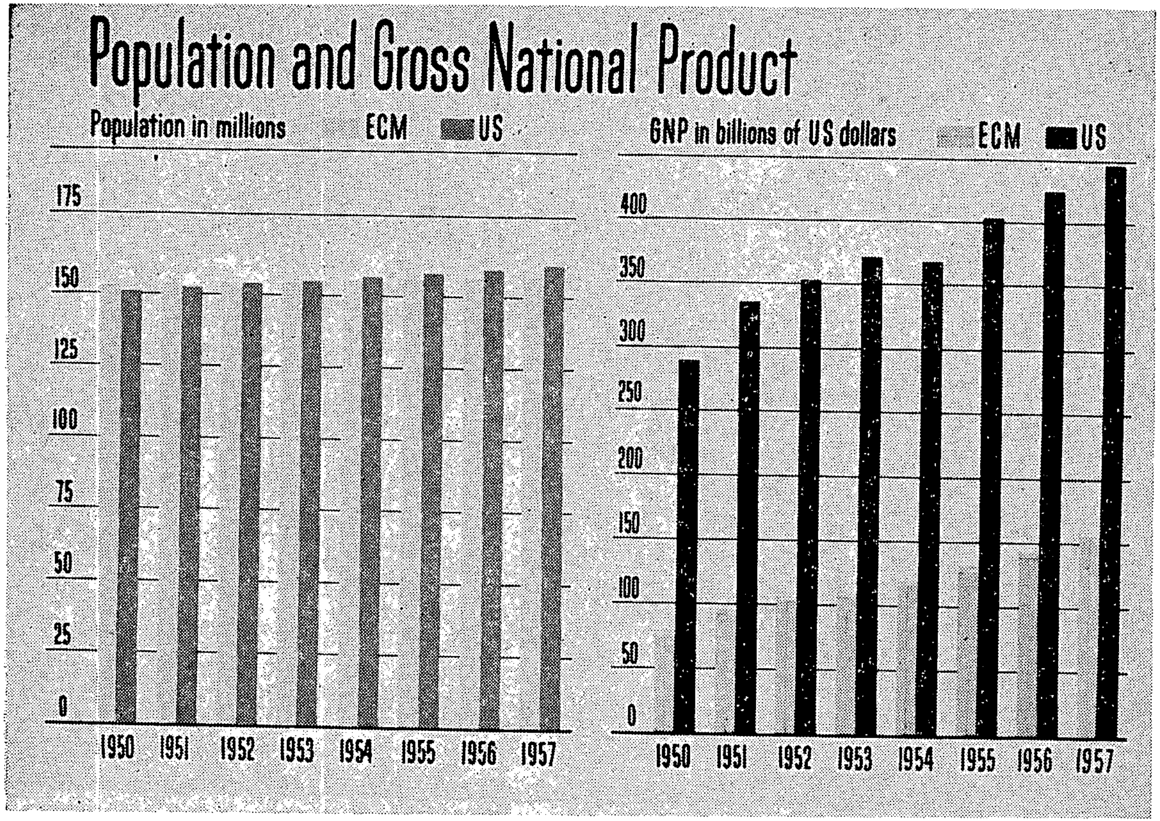
1956
1957
1958


Population and Gross National Product
Population in millions
ECM
US
175
150
125
100
75
50
25
0
1950
1951
1952
1953
1954
1955
1956
1957
GNP in billions of US dollars
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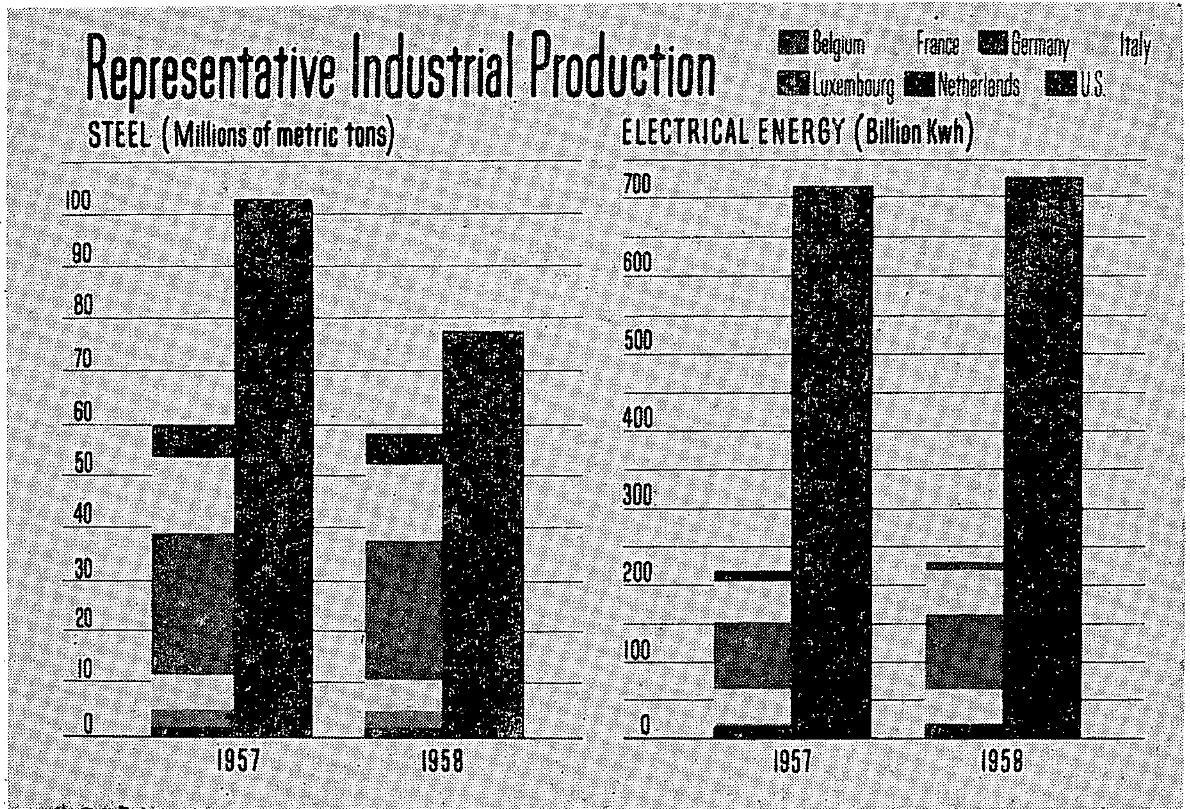
1953
1954
1955
1956
1957


Representative Industrial Production
Belgium
France
Germany
Italy
Luxembourg
Netherlands
U.S.
STEEL (Millions of metric tons)
100
90
80
70
60
50
40
30
20
10
0
1957
1958
ELECTRICAL ENERGY (Billion Kwh)
700
600
500
400
300
200
100
0
1957
1958

The CHAIRMAN. The next witness is Mr. Emile Despres, professor of economics at Williams College.

We are glad to have you, sir.

## STATEMENT OF EMILE DESPRES, PROFESSOR OF ECONOMICS, WILLIAMS COLLEGE

Mr. DESPRES. Thank you, Mr. Chairman. I will not attempt to read my paper, partly because it is too long, and also partly because a part of the paper overlaps ground that was covered by yesterday's panel and hardly needs to be repeated.

The most general point I have about the Common Market is this: That it contains highly constructive unifying potentialities both at the economic and at the political level, and also contains divisive potentialities, and that it is in the interests of the United States to emphasize the positive: That is, to minimize the divisive dangers that cannot be wholly ignored today.

A good deal of my paper talks about the divisive potentialities. The reason for that is this: I think Americans who have been interested in these matters have been so very greatly impressed by the high-mindedness and the dedication of the individuals in Europe who have been in back of this movement that they have tended to overlook the divisive dangers. With respect to these dangers, I do not think that they are unavoidable. I do think that the chances of avoiding them depend a lot on U.S. policy.

This is a general observation, and I think it explains the emphasis of the detailed points which I am about to make.

First of all, so far as the economics of the Common Market are concerned, I think that the main economic effect to which we may reasonably look forward in the Common Market countries themselves, is a reinforcement of the growth trend, the increases in productivity that have been evident over recent years, and that this will be achieved essentially through enlargement and broadening of competition within the Common Market.

The reason I stress this point is this: That ordinarily in the theory of international trade, the usual argument for liberalization of trade is that it enables the trading countries to take advantage of the differences in their endowment of resources and of skills. In the case of Common Market countries, the economic similarities are more important than the differences, so that the classical comparative-advantage argument does not deserve much emphasis here.

In the popular discussion of the Common Market, a great deal has been made of the point that a larger market will enable European industry to adopt mass production methods which were not possible or profitable for them before. I think also that this point is overworked a good deal, though there is something to it.

The main point is that by the freeing of markets, the broadening of competition, you will get a very powerful, dynamic spur to technological innovation and improvement, and that it is through the dynamism of increased competition that I think we may look forward to a reinforcement and perhaps a strengthening or broadening of the existing strong upward trend of growth in productivity and income in this group of countries.

That is the main point I have as regards the economic effects in the countries comprising the Common Market themselves. So far as effects on their trade with the outside world are concerned, I have tried to analyze this in somewhat elaborate fashion by distinguishing between two types of effects.

What I called the growth effect is the effect on external trade of the Common Market countries of their own internal growth and productivity. Here, in some cases, the growth in productivity will mean that some goods formerly imported from outside will now be produced domestically. On the whole, however, the growth of productivity and of real income within the Common Market means a net increase both in their exports and in their demand for imports. Often when these matters are discussed, it is the increased export competition which is talked about, while the effect of the rise in real income, in increasing demand for imports, is overlooked.

This is the growth effect. The other effect I have called the displacement effect. This occurs in any customs union, whenever as the result of the removal of internal barriers some goods that one of the member countries formerly bought from outside, it now buys from another member of the customs union.

The effect of this kind of trade displacement is, of course, on balance restrictive, so far as trade with the outside world is concerned. It ought, also to be said that this kind of trade displacement is in general, not invariably but in general, uneconomic, both in its effects on the outside country and in its effect on the Common Market countries themselves.

I have so far talked about trade with the outside world as a whole. It is important to try to break down a litle bit the geographical impact of the two types of effect: The growth effect and the displacement effect.

The trade displacement effect, the restrictive effect, will be most sharply felt in trade between the Common Market countries and the Western European countries outside the Common Market, unless the common external tariff and other barriers of the Common Market are very low. "Very low" is an elusive phrase; but I mean a lot lower than the level in Mr. Ball's chart.

The reason I say this is that owing to the similarities of the resources and skills of the Common Market countries and the Western European countries outside the Common Market, a degree of tariff discrimination which is only moderate may have a rather large trade-displacing effect. To the extent that this happens, the effect is essentially to draw a line of division within the Western European group itself.

Of the countries likely to be affected by this, most of the continental European countries outside the Common Market have 30 percent or more—up to about 50 percent for Austria—of their exports going to Common Market countries today. For the United Kingdom, the percentage is much smaller. I think it is about 14 percent. The impact, therefore, if this problem is not well resolved, is likely to be most serious for the continental Western European nonmember countries, but also serious for the United Kingdom.

So far as the effects on our own trade, U.S. trade, with the Common Market countries are concerned, I think it is fair to say the displacement effects of the discrimination element in the Common Market will be slight, largely because the major portion of our exports to these countries is of complementary products, not competitive products. About one-third of our exports to the Common Market countries are of manufactures. The rest are primary products—agricultural goods, coal, and so on.

The main effect, so far as U.S. trade is concerned, will be the growth effect. This means merely a continuation and perhaps a strengthening of the tendencies that have been apparent, that have been operating in the past few years.

American manufacturers, therefore, may expect intensified competition, as they have been experiencing in the past few years, from European manufacturers. But as I pointed out in my general discussion of the growth effects, the effect is not merely intensified competition on the part of the European countries. The effect is also a growth in their real income, and, therefore, intensified demand for imports.

So in analyzing the effects on American foreign trade you have to weigh these two factors, the intensified competition and the growing demand for imports.

The real question is: Which will outweigh the other?

I am inclined to answer this by saying that on a realistic assessment of today's probabilities, the competition effect for some years is likely to outweigh the effect of rising demand in these countries for American products.

The rising demand for American products would impinge chiefly, I think, on these complementary goods which we are now exporting to Europe. This means to a large extent agricultural products.

At the same time that in industry you have had a very rapid growth of Western European productivity, especially in certain branches of industry, you have had in agriculture an extremely rapid growth of productivity in the United States, so that if trade in the real world followed the lines of comparative advantage, we might expect a very, very large increase in American agricultural exports to Europe.

The only joker here is in the phrase, "if trade followed the lines of comparative advantage." The point, of course, is that agricultural protectionism in Europe is very high. Moreover, as you read the agricultural provisions of the Treaty of Rome, there does not appear to be any intention of lowering external barriers here appreciably. In other words, a controlled and subsidized domestic agriculture within these countries is to be maintained.

So that although I would expect, despite European agricultural protectionism, some appreciable increase in our agricultural exports to these countries, nevertheless, in relation to the true underlying economic potentialities, the increase that we are likely to get, unless agriculture protectionism is very considerably reduced over the years, is likely to be small.

The conclusion I reach, therefore, is that for the short or even the intermediate run, the effect of intensified European competition is likely to be more strongly felt by the American economy than the effect of an enlargement of their demand for our products. The reason I say this is the high import barriers so far as agriculture is concerned.

Senator BUSH. May I ask one question, Mr. Chairman?

The CHAIRMAN. Yes.

Senator BUSH. Is it fair to paraphrase that, then, by saying that these conditions should extend to increase our imports more than our exports?

Mr. DESPRES. Yes.

Senator BUSH. That is the net of it?

Mr. DESPRES. Yes.

Senator BUSH. There is no way of measuring the relative increase of one against the other, I suppose?

Mr. DESPRES. There are ways of doing a lot more work on this subject than I have done, sir, but I have not attempted to quantify it. It would be an elaborate kind of an undertaking to do so. But it is true, I think, that the effect on our exports is going to be limited by the fact that there are very severe barriers abroad to expansion of our agricultural exports. It is also true that the agricultural policies of all of the industrially advanced countries, including our own, are to support agricultural income, support agricultural prices, and to develop a kind of a controlled agriculture.

Senator BUSH. May I ask the question another way, Mr. Chairman?

Would you conclude that both our exports and imports would increase as a result of the Common Market existence, or would you suppose that its existence would cause a decline in our exports, an increase in our imports? Or would both increase? Do you see what I mean?

Mr. DESPRES. Yes; I see what you mean.

Some of our exports will increase; that is, despite everything I have said, we can expect a trend of increase in our agricultural exports. It is just a lot lower trend than we could have if barriers were lower. Also, I would say with respect to coal, even though there is excess capacity in Europe today, on the whole, expanding energy requirements in Europe seem to me to suggest that there is a real possibility, for some years at least, of a trend of growth in our coal exports to these countries, although for the longer run one would have to talk about some substitution of atomic energy and also other forms of energy—oil and so on.

Representative BOGGS. Mr. Chairman?

The CHAIRMAN. Yes, Mr. Boggs.

Representative BOGGS. You are, of course, assuming, Mr. Despres, that the six will proceed in a more protectionist fashion than a liberal fashion, are you not?

Mr. DESPRES. No, sir. I am assuming that—well, as a matter of fact, I have some policy recommendations at the end. Let me put it this way:

I fear that the relaxation of agricultural protection by these countries, and by Western European countries in general, will at the very best be slow, and this I think is very clear in the Treaty of Rome provisions. I think that on a realistic assessment of how fact it is possible for democratic governments to move, say, in the taking away of subsidies from an important group like their own agricultural people, one has to assume that these barriers in the agricultural sector are not going to disappear overnight.

I think it is highly important that we urge their reduction, and I would be hopeful that through active U.S. negotiations on the matter we might be able to induce them to develop a long-term program for gradual easing of these barriers. I think this would be a notable accomplishment, and that would be fine.

Representative Boggs. Are they not trying to do this? Dr. Hallstein, the president of the Common Market, was here recently, and we met with him. This was one of the main things we discussed with him, whether or not the six would move ahead in a protectionist fashion insofar as the rest of the world is concerned or whether the direction would be more liberal.

It is his contention that their whole direction is liberal, and that much more is involved than just their relationship with the other 11 in Europe. He also says that they plan to operate through GATT and all the existing arrangements.

Mr. Despres. I do not mean to sound cynical, because I do not feel cynical about this, but I would say only this: That this is certainly an aspiration, I feel, of men like Professor Hallstein. And even though the general direction is a liberal one, just as the general direction of our commercial policy has over the past 25 years been a liberal one, it has to be noted that we have made important exceptions for agricultural products, and the treaty of Rome makes important exceptions for agricultural products, and this is a really tough problem. I think something can be done about it, but I think it would be very helpful to the Europeans who would like to see this kind of development if the U.S. Government took an active role in attempting to bring about a long-term program of tariff reduction.

On the assessment of the long-term prospects, all I can say is that I think it would be naive to expect these barriers to come down very fast of themselves.

That is about all I had in mind.

Representative Boggs. I do not think anyone expects that. I think it is a question of direction.

Mr. Despres. That is quite right.

Representative Boggs. Another thing. In connection with Senator Bush's question on this point, the increment of American investment in the Common Market is increasing tremendously. This is a direct investment in these countries: West Germany, France, and elsewhere. This, of course, has some effect on exports and imports, because American capital is going to the market frequently. Is that not a fact?

Mr. Despres. Yes, it is. The Common Market has been certainly a factor contributing to this flow of American capital. But, as Mr. Ball pointed out, the movement was already underway, and it is essentially a reflection of the strong trend of growth and of the active and lively potentialities for further growth in these countries.

In addition to the trade effects that I mentioned, there is the important effect of the increased movement of American capital to Western Europe and to the Common Market countries.

Representative Widnall. Mr. Chairman?

The Chairman. Mr. Widnall.

Representative Widnall. Professor, I take it from scanning your statement that you think time is of the essence in completing financial arrangements and trade negotiations; that there will be built into the operation of the Common Market such discriminations that if we do not complete our negotiations soon, it can be in a very bad way. Is that not one of the main points you make?

Mr. DESPRES. It is, yes; or, I would say, if we do not begin to launch them soon. I regard the negotiation process as a prolonged and indeed a continuing process, just as the Common Market is an evolving institution. But I think we ought to begin the negotiations soon, because otherwise vested interests begin to get built up in the wrong direction, and it gets harder to undo things after they have been established.

Representative WIDNALL. What was the real reason for the breakdown of the negotiations that Great Britain is conducting? Antipathy on the part of France more than anything else?

Mr. DESPRES. I would like to sidestep that in part, partly because I do not have inside information on this matter, partly because I think our approach to it ought not to be to allocate blame, but rather essentially it seems to me, this idea of the free trade area is a fairly dead one, and there are a lot of reasons why it did not even get to first base. I also regard the scheme as far from ideal, although I thought that it was a pity that this did not result in a beginning of serious negotiation. The talks about it, they never got into any real details.

The point that Mr. Ball made, that the British were asking for quite a lot and were not offering to give very much, is a valid point.

Representative BOGGS. There is one school of thought that the British did not think this would ever come to pass; and it having done so, it was chagrined, to put it mildly.

Mr. DESPRES. However, it ought to be said, if one is interested in the politics of this, there are elements on the other side. As to the people who support the Common Market, if you analyze all of the bases of support, it is not merely the dream of European unity and supernational authorities. In the eyes of the French Government, for example, the fact that France, with some support from Germany, and resources, can become a relatively stronger power, they hope, in the councils of Europe, may be a more important influence to the leaders of the French Government than the appeal of supernational ideas.

But I do not like to make comments like this, because to the extent that I feel any indignation in these matters, my indignation is very evenly distributed, and I do not think it is a matter for indignation anyway. I think we ought just to ask ourselves what is America's and the free world's interest here, and in examining any country's political motives for doing anything they do, good or bad, you can do a good smear job if you want to, but I do not want to.

The CHAIRMAN. I would say there is no reason for indignation in this matter, if I may interject. Such motives were certainly expressed in the formation of the American Union. The statesmen from Massachusetts realized they would have a larger scope for their abilities in a union of the 13 States, and Massachusetts being separate, or the States splitting up into 3 confederations gave them an opportunity to develop on a national scale they would not otherwise have had, gave the great leaders from Virginia a chance to become national leaders.

You must have these realities, really, if we are going to bring about a greater degree of cooperation.

Mr. DESPRES. In the German case I would say that very clearly the motive of Chancellor Adenauer is French-German rapprochement and its institutionalization. The awkward point here is that the Minister on the other side of this issue, Dr. Ehrhard, has a case which is not wholly without merit. It emphasizes the economic side of things and recognizes the need for integrating the Common Market with the Western European economy as a whole.

Now, the point is that it is too bad from the point of view of German politics that this kind of issue has to arise as a source of division. This, too, is not in our interests.

The CHAIRMAN. Our own Patrick Henry was opposed to the Constitution and the United States of America.

Mr. DESPRES. The next point I wanted to make was made yesterday; namely, Western Europe's dollar shortage problem is in my judgment at an end, and it is indeed possible that the trend for many years may continue to be somewhat in the other direction. This is, on the whole, a highly welcome and salutory development. It is exactly the thing we were trying to achieve through the Marshall plan, and we ought to be delighted that it has been so very well achieved.

The reasons why I make this assessment of the existing position to a large extent duplicate those that were made yesterday. There is one other reason I would like to add; namely, the agricultural point. If this were a world of freer trade, the effect on our foreign trade of the increased European competition in industrial goods would be much more largely offset by increased American exports of agricultural goods, because here is where our productivity is growing most rapidly. But unfortunately, the barriers will tend to limit this expansion of our agricultural exports, so this is a further reason for thinking that the balance-of-payments picture has undergone a major shift.

I would like to make a comment about the "pricing ourselves out of the market" line, which is very fashionable today. I do not know exactly what the phrase means, but if it means that inflation in the United States is causing us to lose export markets, and if by inflation you mean a rise in the average general level of prices, it is dead wrong, because the general level of prices in the countries of Western Europe has on the whole gone up a good deal more during this period of rising European competition than the American price level has gone up.

The cause of the increased competition is that in some important industrial lines, their productivity has been rising a great deal more than ours has. You have a table in the President's Economic Report showing that for the prices of certain classifications of machinery our prices have gone up more than Western European prices, even though the general average of prices has gone up more there than here.

So if our trade balance were moving in response to the relative degrees of inflation here and abroad, we would be having increasing exports and reduced imports today. This inflation line, therefore, does not stand up as an explanation of the changes in our trade balance.

I have a few policy recommendations I would like to mention.

First, I agree with the people who spoke yesterday on the desirability of attempting to bring about a reallocation of the costs of NATO defense to some extent.

Second, I agree with the people who spoke yesterday on the desirability of the Germans taking on a larger share of the financing of underdeveloped countries.

In addition to that, I have four points of my own I would like to make:

First, because of our changed balance-of-payments position, we are in a much stronger position today to use the Reciprocal Trade Agreements Act as an effective bargaining instrument than we have even been since the passage of the first act in 1934. At a time when the world was suffering from dollar shortage, to tell them to reduce their barriers against American goods was all right, but they were entirely ready to import more American goods if they had the dollars to pay for them. So we were not able to expect them to do more than that in any event.

The CHAIRMAN. How would you define "dollar shortage"? May I define it for you? It is a desire to import American goods for which the foreign country has neither the means nor the desire to pay.

Mr. DESPRES. I was slow on the uptake. I would be glad to take your definition.

Senator BUSH. I would object to part of that, but I think it is a good start.

The CHAIRMAN. Excuse me, sir. This is an aside. But I have often been puzzled by these rather glib phrases, that the European countries have had "a dollar shortage."

Mr. DESPRES. This is a wide-open subject, but I would say, just historically, there has been, since the early thirties at least, and some would carry it back to World War I, what might be called a chronic tendency for our external receipts to exceed our external payments; other countries were more or less continually under pressure to find new measures to cut down on their use of dollars or to expand their dollar receipts. This has been the kind of problem that people have been discussing in using the phrase "dollar shortage." The rest of the world did not have a genuine payments equilibrium with the United States. Things were kept in line, after a fashion, by such devices as foreign exchange rationing and import quotas, currency devaluations and, at times, severe domestic deflation and unemployment.

The CHAIRMAN. What you are saying is that whatever the dollar shortage was, it has largely disappeared?

Mr. DESPRES. That is right. And this is an important change, even if we might disagree about its definition.

The other point would be: And, therefore, we have a new opportunity in our trade negotiations; the change in our balance-of-payments position and in that of Western Europe means we have a stronger bargaining position than we had before since Western European countries have much greater leeway for reducing their trade barriers.

I think we ought to use this bargaining position for three main purposes: (1) to try to get the Common Market to adopt a very low external tariff; (2) to abolish as soon as possible—and it will take a while, certainly—the quantitative import restrictions on manufactured goods which are against GATT but were justified under the

GATT provision that these could be used to meet balance-of-payments problems. The quantitative restrictions are still on, even though the balance-of-payments problem of the countries using them is gone.

But we ought to press hard for their removal.

Senator BUSH. Mr. Chairman.

Does that refer to quotas, for instance?

Mr. DESPRES. Yes.

Senator BUSH. Import quotas?

Mr. DESPRES. The general provisions of GATT, as you know, are against import quotas. There are three exceptions. First, the country may resort to them for balance-of-payments reasons; second, there are exceptions for agricultural goods; and third, there are exceptions for underdeveloped countries.

So far as the Western European countries are concerned, and their imports of manufactures, they are supposed under GATT not to use quantitative import restrictions any more, and we ought to urge this line very strongly in negotiations both with Common Market countries and with other Western European countries.

Senator BUSH. Mr. Chairman, I have a question I would like to impose right here at this point.

The CHAIRMAN. Yes, indeed.

Senator BUSH. This question of quota is, of course, a very interesting one. It is a very important one. As long as you are touching on it there, I would like to ask this question.

I will illustrate it by a situation which we are faced with right now, which is in the field of stainless steel flatware, which is made in other countries just as good as it is made in this country, according to our own manufacturers' statements; but, due principally to the labor cost differential in other countries, notably Japan in this instance, but others, too, they are able to undersell our products to such a great extent that no tariff protection is valid; and in order to alleviate the distress to some extent of American manufacturers, the Government worked out a voluntary import quota which the Japanese themselves adopted, and you are probably familiar with that.

The question I wanted to ask you is: Is it a bad thing or a good thing, in cases like that, for us to establish a quota, either a fixed quota or perhaps preferably a percentage-of-the-market quota, based on a recent figure of importation, so as to let a country increase as the market increases, or should the quota not be used at all?

What is your comment on it? And if you don't like it, tell me so.

Mr. DESPRES. You have anticipated my reaction. I do not like it. I do not know the details of the particular case. I would say this, though: No tariff within the realm of plausibility can overcome this differential. I find it hard to accept the view that it is merely low Japanese wages or something of that sort, and I would urge that in general there is some better way that these manufacturers could use their resources. In other words, I would say on the whole I would be opposed to the use of quotas, and I would like to add this: That in the situation of today's world, the pressure for increased American protectionism and the use of quotas and higher tariffs, and so on, as well as for cutting aid and all the rest of it is going to be very strong, unless the countries with whom we trade pursue real trade liberalization policies to remove discriminations against American goods.

But my answer to your specific question is, I am against the use of the quotas because if an industry needs quotas because a high tariff would not do, then it must be at an awfully strong competitive disadvantage, and there must be some other way we could use our resources. The people in that industry could shift to some other kind of manufacturing.

Senator BUSH. A protective tariff may be used in such a case. Let us say a device that can be used to restrict imports has the purpose of a protective tariff, has it not?

Mr. DESPRES. That is the purpose; yes.

Senator BUSH. The purpose of the quota is the same thing. I could see cases where a high tariff might prohibit them, whereas a quota might encourage them. Do you see what I mean? If the quota is set at a reasonable figure in a growing industry, say you were going to give 30 percent of the stainless steel flatware market to the world——

Mr. DESPRES. Well, the line I would draw is, in general I am opposed to protection of any sort, whether by tariff or by quota. Although you are able to conceive of a case where a protective tariff would be even more restrictive or prohibitive than a quota, usually it is the other way around: That a quota device is resorted to in just the kind of situation you have mentioned, where the degree of protection that would be afforded by even a pretty high protective tariff would not have the desired effect.

So even though conceivably you could think of it as the other way around, that is not the way it works in practice.

Senator BUSH. I might agree with you in your general premise, that all these restrictions are undesirable, and wish we did not have to deal with them at all. But actually, politically, we have a realistic problem here. There is no doubt about that in your mind, is there? We do have a problem to face?

Mr. DESPRES. I agree with you.

Senator BUSH. The point I am trying to develop for my own guidance and the guidance of the Congress—it is the purpose of these hearings, of course—is an expert opinion on why a tariff may be all right in certain instances but a quota is not.

Mr. DESPRES. It is because on the average and in general, quotas are used as more drastic import-curtailing devices than tariffs. This would be the main line I would urge.

Senator BUSH. But suppose they were used with moderation, so as not to foreclose imports but perhaps to encourage them?

Mr. DESPRES. There is another reason of course, if you are interested in revenue. If you leave tariffs alone and you impose an import quota, the particular foreign exporters who get in under that quota will be able to sell their product without cutting prices so much, so they will get a monopoly profit of a large sort. If you raise tariffs, this monopoly profit becomes additional public revenue to the United States.

Senator BUSH. That is a good point.

Mr. DESPRES. So in addition to the other point that I made, you do get revenue to the extent that a protective tariff is not completely prohibitive, and if you just sort of allocate the market like a cartel, which is what a quota does, you would give a monopoly benefit to the particular foreign exporters who get in under the wire.

Mr. BALL. Mr. Chairman, may I add a point to this?

The CHAIRMAN. Certainly.

Mr. BALL. It seems to me also, in addition to what Professor Despres has very ably said, that the problem of quota is that it does nothing to encourage productivity, whereas even if a tariff is high enough, the American producer may still be stimulated to get his prices down in order to get more of the market than he would otherwise have. But if the market is frozen by a quota device, then there is absolutely no incentive for him to become more productive and attempt to meet the competition.

Would you agree with that?

Mr. DESPRES. Yes; I certainly would. If the tariff is moderate rather than prohibitive, the situation is more healthily competitive than under a quota. The domestic manufacturer has a chance to expand his share of the market by improving his product or his efficiency; so does the foreign exporter. The consumer benefits and the total market grows.

Senator BUSH. I think theoretically that is very sound, but in practice I wonder whether it is so sound. I do not know whether Mr. Ball is familiar with this issue or not, of the stainless steel flatware.

Mr. BALL. I know in general; I heard about it; yes.

Senator BUSH. I would be inclined to observe from my contact with that case, which may be typical of many, that the quota would not discourage them in attempting to improve production, because they have a market that is capable of lots of further development; and the lower you can get the price, the broader the market is likely to become with most any kind of merchandise.

Mr. BALL. It depends on the question of the elasticity of demand for the commodity, does it not?

Senator BUSH. Yes. But I would not go all the way with you on that last statement, because I think that the quota might not take away the incentive to reduce costs, because the incentive to improve the market, broaden the market, would still remain, even though there was a quota, say, of 25 percent of last year's market.

Mr. BALL. I would not have a judgment as to how elastic the demand for stainless steel flatware might be, but I would suppose that it is not a commodity in regard to which you would get great elasticity. If that is the case, what you are doing by imposing a quota is to discourage the incentive which might otherwise exist for increased productivity.

Representative BOGGS. Of course this is the historic argument between those who favor a more liberal trade policy and those who favor protectionism. A quota historically was the most protective device you could think of. What a quota really says is that after you reach X number of a given commodity, whatever it may be, there shall be no further imports of that commodity.

So in the case of a tariff, assuming that you have greater efficiency in the exporting nation, you might still be able to put over them a tariff and compete in their market,

In all of these things, this wage question is an interesting one to me, because on our subcommittee on the Ways and Means Committee, we went into this rather thoroughly.

Oftentimes these things are not as simple as they appear on the surface. Take the case of the electrical equipment in England. The whole contention of our people was that they were put at a competitive disadvantage because of the wage rates in the United States compared to the English wage rates. It was later shown that the situation was just the reverse.

We have a problem in my State about the import of crude petroleum. Yet they pay higher wages in the Venezuelan oil fields than in our oil fields.

So these things are not necessarily true in this wage business. When you use the wage rates, you have to look at lots of other things: fringe benefits, social security, and so on.

Mr. DESPRES. I would like to summarize this by saying that I think we ought to launch actively trade negotiations now for a number of purposes: First, to try to get a low external tariff for the Common Market. I am afraid that if the Western European countries negotiate this without our active participation, it may go badly in terms of both our economic and our political interests in a unified Europe. Second, that we ought, as part of these negotiations, to try to get a removal of the discriminations against American goods that were formerly—in quotes—justified, or actually justified on balance-of-payments grounds. Third, that we ought to try to do something over a period of years about European agricultural protectionism; and finally, if we do not achieve substantial success in these negotiations, I would expect that the domestic pressures for increased protectionism will be strong in this country, and I think that is the best way available to us to keep these from increasing in strength.

I also have a monetary proposal to which I attach importance, but it would take at least 5 minutes to expound it, and a long time ago I heard something said about 10 or 15 minutes per panelist; so if the chairman agrees, I think I will forego that discussion.

The CHAIRMAN. Would you be willing to submit it in writing so it could be printed in the record?

Mr. DESPRES. It is covered very briefly at the end of my statement.

The CHAIRMAN. I do not want to shut you off, Professor Despres, but we still have Professor Scitovsky's statement to come.

Is it included in your statement?

Mr. DESPRES. It is; yes.

Senator BUSH. Would you call attention to it by page number?

Mr. DESPRES. It is the poorest and most obscure paragraph in the statement. It was written last and obviously in a hurry.

The CHAIRMAN. Does this have something to do with the Zurich bankers?

Mr. DESPRES. Here, I would rather not find any devils, either.

The CHAIRMAN. That is supposed to be the force from which the raids on so-called hot money come, as we hear from Geneva.

Mr. DESPRES. Yes; but the kind of movements I fear are movements of a magnitude that could run into a good many billions, but I know those Zurich bankers are richer than they look, and they may have a role in it.

The CHAIRMAN. Thank you very much, Mr. Despres. Your written statement will be placed in the record at this point.

38563—59—pt. 5——10

(The statement referred to follows:)

STATEMENT OF EMILE DESPRES, PROFESSOR OF ECONOMICS, WILLIAMS COLLEGE, ON THE SIGNIFICANCE OF THE EUROPEAN COMMON MARKET TO THE AMERICAN ECONOMY

My name is Emile Despres. I teach international economics at Williams College. I have been asked to discuss the significance of the European Common Market for the American economy.

Most of the articles which I have seen on the European Common Market or Economic Community begin by characterizing it as "one of the most important undertakings of the 20th century" or "one of the most far-reaching economic undertakings of all time." However, in these articles the discussion that follows of the economic effects of the Common Market is often vague and indefinite. One might, perhaps, wonder whether the Common Market will be really so momentous after all.

Before discussing specific economic matters, I should like to make a general comment about this. Vagueness in discussing the Common Market is unavoidable not only because the Treaty of Rome establishing the Common Market contains its share of escape clauses, loopholes, and ambiguities, but, more important, because the plan is incomplete and unfinished in one decisively important respect. The issues concerning commercial and financial relationships between the Economic Community, on the one hand, and other Western European countries and the rest of the free world, on the other hand, remain unresolved. If this problem is worked out well, the Common Market will both strengthen free world political unity and stimulate its economic growth. In this sense, the Common Market is a momentous project. If the problem is badly resolved, however, the Common Market may be a source of chronic political tension and disunity and economic disruption. Its results might then be momentous in a radically different sense.

The British proposal of a free trade area, although far from ideal, represented a first, constructive attempt to meet this issue. Now that this scheme has been firmly rejected, the time is ripe for a new effort toward a constructive solution, and his country's role in this effort should be an active one. I shall return to this point later.

### I. EFFECTS WITHIN THE COMMON MARKET

In considering the economic effects of the Common Market, the first point to be noted is that, apart from its temporary, psychological impact, which has been one of the factors stimulating a flow of both European and American capital into the Economic Community countries, the fundamental economic effects will be felt only gradually as the Common Market comes slowly into effect over a 12- to 15-year period.

A second major point is that the economic similarities among the countries composing the Economic Community are much more striking than their differences; all are exporters of manufactures and all import primary products. As a result, the classical argument for trade liberalization, that it enables countries to derive mutual benefit from their differences in resources and skills, has limited applicability to the Common Market. The popular view that the removal of barriers and the creation of a large, free market will permit industries to adopt more efficient mass production methods which would not have been profitable when producing for limited, national markets seems to me also to deserve only moderate weight. The principal constructive economic effect of the Common Market is that, as it goes gradually into effect, the market for manufactured goods within the six countries composing the Economic Community will become more dynamically competitive than it has been in the past.

Improvement in technology and growth of productivity has been exceedingly rapid in Western Europe in recent years, and the technological gap between Western European and American industry has narrowed considerably in a number of manufacturing lines. As an illustration, although inflation in the general level of prices has been greater in Western European countries than here, their prices for metal products, machinery, and vehicles have, on the average, gone up much less than ours.

In many manufacturing industries, however, the technological inferiority of Western Europe still remains pronounced. A major cause is the lack of progressiveness and enterprise of many European business firms operating under sheltered conditions and accustomed to low volume and high profit margins per unit. Under the more competitive conditions which the Common Market will gradually create, a strong premium will be placed on managerial efficiency and progressiveness. Production will tend to concentrate in those firms which adopt improved methods and install more efficient equipment. Chiefly through enlargement of competition, the Common Market may be expected to spur technological progress, increased investment, higher productivity, and growth of real income. In this way, it will serve to sustain the strong upward trend of growth evident over the past decade. In this respect, the Common Market, instead of creating a new trend, will bolster a trend already strongly present in the Common Market countries.

This enlargement of competition will not be without limitations and restraints. In the field of agriculture, for example, the substitution of competition for the several national programs of price and income support and production control is not contemplated. Instead, these programs will be gradually coordinated into a communitywide program of subsidization and control under the protection of uniform import restrictions for the Common Market as a whole. In some industries, also, it is possible that present national cartels, cartel-type arrangements, and governmental subsidies will simply be replaced by wider cartels and price-fixing arrangements and coordinated subsidies to protect and sustain inefficiency and backwardness.

Despite this qualification, the general trend in manufacturing will be toward gradual enlargement of competition, disappearance of inefficient firms, and expansion of investment and output in efficient and progressive firms. This promises to be the most important, constructive economic result of the Common Market, just as, at the political level, the strengthening and institutionalization of French-German cooperation appears to be its most constructive longrun potentiality.

Of the countries composing the Common Market, France and Italy may be the largest gainers. Their productivity is likely to benefit most from enlargement of competition, and the postwar evolution in industrial organization and management which has been taking place in some important branches of French and Italian industry will be broadened and extended.

## II. EXTERNAL EFFECTS OF THE COMMON MARKET

The questions of the effects on trade between the Common Market and other countries in general, and on our foreign trade and balance of payments in particular, are matters of particular interest to the members of this committee. In considering trade and payments between the Common Market and the outside world it is necessary to distinguish two opposing types of effect—a growth effect and a displacement effect.

In the first place, there will be the group of effects associated with growth of productivity and real income in the Common Market countries. Growth of productivity and real income in these countries will be accompanied by expansion both in their volume of exports and in their demand for imports. To be sure, rapid technological progress in import-competing lines tends to reduce dependence upon imports. However, unless the gains in productivity are narrowly concentrated in his group of industries—and there is no reason to expect this in the case of the Common Market—this tendency will be overshadowed by the increase in exports resulting from other gains in productivity and by the rising aggregate demand for goods, including imported goods, resulting from growing production and real income. Thus, the net effect of growth is to expand import and export trade with the outside world.

The displacing effect, on the other hand, results from the discrimination which is in some degree inherent in any customs union or preferential trading arrangement. It will occur in the Common Market, whenever the lowering of trade barriers within the Community induces a member to purchase from another member goods which would otherwise have been imported from outside. As barriers within the Community are progressively lowered, the inducement to diversion or displacement of outside trade become stronger. Generally speaking, such diversion of trade is likely to be uneconomic not only in its effects on outside countries but even in its effects on the members of the Community themselves.

The net resulting effect on the trade of Common Market countries with the outside world will depend upon the comparative strength of the opposing forces of growth and of displacement. Two highly important general conclusions may be drawn.

First, the relative strength of these two opposing forces will be chiefly determined by the level of the import barrier surrounding the Common Market. If the import barrier is high, the displacing effect will be large and the general effect on external trade will tend to be restrictive. If the barrier is low the growth effect will be predominant, and the effect on external trade will be expansive. It is for this reason that the unresolved issues concerning the future commercial relationships between the Economic Community and other countries are of crucial importance.

It should be noted, in this connection, that a low import barrier against outside trade would not only serve to reduce the displacement effect; generally speaking, it would also enlarge the growth effect by further enlarging competition and giving further momentum to growth of productivity within the Common Market. Thus, the effectiveness of the Common Market in stimulating the economic growth of its own members, far from being strengthened by high external tariffs and quotas, would be considerably weakened.

Second, the specific geographical impacts on outside countries of the growth and displacement effects, respectively, will be highly diverse. Although a comprehensive analysis of country-by-country effects would be out of place here, it is necessary to make some general observations on this matter. Even if high import barriers should surround the Common Market, the growth effect is likely to remain important in the case of trade with exporters of complementary products. Outside countries exporting primary products which the Common Market needs and cannot readily produce for itself are likely to benefit from the Common Market's increasing demands for their products as well as from its growing role as an exporter of machinery and other manufactured goods. Although for trade with outside countries exporting primary products growth effects will predominate in most cases, displacement effects will not be wholly absent. The Common Market plan contemplates eventual free entry into all Common Market countries of French and Belgian colonial products as well as increased investment to expand production in their African territories. This has possible displacement implications for outside producers of such products as oil, coffee, cocoa, tobacco, and bananas. Moreover, it should be emphasized that in the case of imported agricultural products of which production within the Common Market countries can be expanded, even if at higher cost—for example, butter from Denmark, or grain from America—the outcome will depend on the evolution of the Common Market's agricultural policy and the degree of protection accorded to agriculture.

In contrast to the situation of outside countries exporting complementary skills of Western European nonmembers are similar to, rather than complementary to, those of the Common Market countries. Consequently, even a moderate degree of tariff preference can have rather large trade displacement effects. This shifting due to discrimination is not only contrary to the interests of Western European nonmembers but is also against the long term interests of the Common Market countries themselves.

The exports of 11 OEEC countries not belonging to the Common Market to the 6 Common Market countries amounted in 1956 to $3.8 billion, or 23 percent of their total exports to all countries. The percentages ranged from 14 percent for Britain to 31 percent for Denmark, 39 percent for Switzerland, and 49 percent for Austria. The postwar expansion in inter-European trade was fostered by the steady extension of measures for liberalization of inter-European trade initiated under the Marshall plan. The movement for inter-European trade liberalization embraced the whole group of OEEC countries. Trade liberalization, besides its important economic benefits, contributed importantly to Western European political solidarity. Whether this solidarity will be greatly weakened or greatly strengthened by the Common Market depends significantly upon whether the Common Market adopts a level of import barriers against outside countries which produces substantial trade displacement. The dangerous possibilities inherent in this issue have been foreshadowed in the prolonged and finally bitter discussion in OEEC of Great Britain's free trade area proposal, and in the strain imposed on British-French relations following France's rejection of this proposal. Trade discrimination within Western Europe, if substantial, may be difficult to reconcile with political solidarity.

This is the essential reason why the European Common Market is so difficult to evaluate. Its favorable effects on growth of productivity in member countries, the strengthening and institutionalizing of French-German cooperation and the possible development of effective supranational instrumentalities and loyalties are its positive potential benefits. However, if at the economic level, the Common Market inflicts serious injury on Western European nonmembers by introducing a substantial degree of trade discrimination, and if, at the political level, the Common Market should become merely an instrument for increasing French prestige and influence in Europe at Great Britain's expenses, the costs of the Common Market, both economic and political, might outweigh its important benefits.

There is, of course, no reason why this must happen. It will not happen if a healthy structure of commercial and financial arrangements between the Common Market and outside countries is negotiated. Two points, however, deserve emphasis. First, the negotiations should not be delayed. As trade discriminations are permitted to develop, vested interests in their continuation are built up and they become increasingly difficult to liquidate. The common tariff provisions set forth in the Treaty of Rome, if actually applied, would result in a high degree of trade discrimination, but the treaty also leaves open the possibility of downward revision through negotiation with outside countries. Second, the failure of Britain's free trade area proposal strongly suggests that the prospect for success of the next round of negotiations will be much enhanced if the United States takes an active role in formulating new proposals and in conducting trade and financial negotiation with the Common Market countries. This would also be of direct economic interest to us. Before presenting certain specific suggestions concerning the kinds of proposals which we should make, it is important to consider the effects of the Common Market on the American economy.

### III. U.S TRADE AND PAYMENTS

Dollar-short Europe has found it necessary to discriminate against American exports since the early 1930's, marked discrimination has been practiced during most of the period since World War II. Despite the progress toward currency convertibility and some relaxation of discriminatory import quotas in the past few years, considerable discrimination remains. Partly because our trade with Western Europe already reflects this discrimination, any further trade displacing effect of the European Common Market in curtailing our exports to its members should be comparatively slight. Our exports to the six Common Market countries amount to about $3 billion annually ($2.8 billion in 1956) or roughly one-sixth of our total exports. About one-third of our exports to the Common Market consists of manufactures, with the remainder primary products. Most of these exports are complementary to rather than competitive with the goods produced within the Common Market. In this respect our situation differs sharply from that of the Western European countries outside the Common Market.

With respect to the foreign trade and balance of payments of the United States, growth of productivity and real income in the Common Market countries is likely to be the factor of greatest importance. Here the long-term effects of the Common Market should serve to merely reinforce a trend already underway. A continuing, strong trend of growth in the Common Market impinges on the American economy in a number of ways. Speaking broadly, intensified competition will be felt in those branches of American industry in which productivity in Common Market countries is increasing most rapidly relatively to ours. For this group of manufactures, one may expect (1) some reduction of American exports to the Common Market, (2) increased exports of this class of Common Market products to the United States, and (3) intensified competition from Common Market products in the markets of third countries. Automobiles are a familiar example of this general class. At the same time, one may anticipate a general tendency toward increased capital outflow to the Common Market countries, owing to repatriation of private foreign funds hoarded in the form of dollar balances in order to take advantage of expanding investment opportunities in the Common Market, direct investment by American corporations in Common Market countries, and some purchases of European securities by individual American investors.

It is important to remember, however, that growth of productivity and growth of real income are opposite sides of the same coin. (This assumes—correctly, I believe—that the effects of growing productivity will not be substantially dissipated through mounting unemployment and idleness.) In assessing the overall effect on our foreign trade and balance of payments, both sides of the coin must be taken into account. While increasing productivity means that American manufacturers will face increasing competition from Common Market products, increasing real income within the Common Market carries with it an increasing demand for American goods.

Both sides of the coin must be taken into account, but there is no necessary implication that they will be equal and that our net balance of payments will remain unaffected. The increase in Common Market demand for American goods will be felt most strongly with respect to our exports of primary products, both agricultural and mineral, which now account for two-thirds of our exports to Common Market countries. The favorable effect of expanding energy requirements in the Common Market on American coal exports needs no emphasis, although in the long run much depends upon the rate at which alternative sources of energy (oil, including African oil, and nuclear energy) are substituted for coal.

In the case of our agricultural exports, it is clear that the underlying long-run economic possibilties for expansion are extremely large. Just as the growth of productivity in Western Europe has been most marked in such fields as metal products, machinery and vehicles, the broad sector of our economy which in the past two decades has shown the most spectacular gain in productivity, both absolutely and in relation to productivity trends abroad has been agriculture. If actual patterns of trade were permitted to adjust to these divergent trends in productivity, and to the resulting shift in the structure of comparative advantage, there can be little doubt that the increasing competition of Western European manufactured exports in world markets would go hand in hand with rapidly growing demands in Western Europe for imported agricultural products, and that the United States would be the largest beneficiary of this growth of demand. Comparison of Western European with American food consumption patterns shows their much higher caloric intake from potatoes and grains, with correspondingly lower consumption of meat and dairy products. Since growth in real income carries with it an increasing demand for costlier foods, it is clear that the combination of expanding manufacturing activity and real incomes abroad and strikingly rapid gains in agricultural productivity here create vast underlying, long-run economic possibilities for expansion of American agricultural exports to the Common Market countries (and to other Western European countries).

Unfortunately, however, realization of this underlying possibility is inhibited by serious obstacles. A sizable expansion of agricultural exports to the Common Market may reasonably be expected, but one major obstacle to the realization of the very large basic potentialities for exapansion of agricultural exports—and the obstacle most pertinent to the committee's present discussion—is European agricultural protectionism. On this score, the agricultural provisions of the Treaty of Rome are not encouraging. A permanent policy of high protection, subsidization and official control is clearly contemplated. In future commercial negotiations with Common Market countries, a strong effort should be made to induce them to adopt a long-term program of gradual reduction of import barriers and domestic agricultural subsidies. It must be admitted that our own past position and the special exceptions for agricultural products which we have included in our past trade liberalization proposals, will be a source of some difficulty in any such negotiations. Nevertheless, this opportunity should ont be neglected since the underlying possibilities for expansion of our exports to Common Market countries are much greater for agricultural products than for manufactured goods.

In addition to the prospective increases in some of our exports to the Common Market resulting from its growth in real income and in import requirements, increased Common Market purchases from other exporters of primary products, e.g., Latin America, will serve indirectly to increase our exports to third countries.

On the whole, however, the guess may be ventured that, so far as the Common Market countries are concerned, and indeed for all Western Europe considered as a single unit, the persistent problem of dollar shortage is at an end. Considering the combined balance of payments for the Common Market countries, or for all Western Europe, on the one hand, and the United States balance of payments, on the other hand, it seems exceedingly difficult to maintain any longer, as so many economists and others have maintained during the postwar period, that for deep-seated structural reasons there is a chronic tendency toward deficit in Western Europe's balance of payments and a chronic surplus tendency in our balance of payments, resulting in chronic dollar scarcity. On the contrary, the underlying tendency for a number of years ahead may even be somewhat the other way. Today's basic international disequilibrium, however, is not dollar shortage but the limited ability of most underdeveloped countries to pay for the imports necessary for their development. This problem involves the whole structure of relations between the whole group of industrially advanced countries and the underdeveloped countries.

My reasons for judging the problem of Europe's dollar shortage to be at an end are (1) the progressive narrowing of the technological gap in many important manufacturing lines, with the expectation that this will continue for some years, (2) the serious obstacles which, for many years at least, will limit the potential expansion of our agricultural exports and (3) the growing movement of investment capital from the United States to Western Europe.

In order that this assessment of the present position and tendency may be properly interpreted, two explanatory comments are necessary. First, it does not mean that individual Western European countries will be freed from balance of payments difficulties. Indeed, reasons were given earlier for anticipating that unless the import barrier surrounding the Common Market is definitely low, serious strains will be imposed on Western European nonmembers. Second, the judgment that Western Europe's dollar shortage disequilibrium is at an end refers only to the underlying position and tendency. Wide short-term fluctuations in international payments and receipts resulting in large surpluses or deficits can result from many causes such as temporary, speculative international movements of funds from one financial center to another, cyclical business fluctuations, divergences between countries in their rates of internally induced inflation or deflation, or revaluations of individual currencies. But there is no longer any reason to consider the demand for dollars as persistently striving to outrun the supply, with Western Europe under chronic pressure to restrain its dollar expenditures.

This progress toward international equilibrium is a development of far-reaching importance, with salutary effects for us and for the free world as a whole. Since this committee has a special interest in the problem of American economic stability and growth, it is worth pointing out that increased competition of European manufactures has been both an important anti-inflationary factor in our markets and a spur to increased efficiency and innovation on the part of American industry. Enlargement of competition is not only a good prescription for the Common Market countries; it is also good for us. European competition is now being keenly felt chiefly in those fields of manufacturing where until recently increases in administered prices and upward wage pressures have been most strongly evident.

### IV. SUGGESTED POLICY IMPLICATIONS

The disappearance of dollar shortage and the launching of the European Common Market mark a major turning point in the structure of free world economic relationships. They create both a highly promising opportunity and an urgent need for (1) commercial arrangements to achieve genuine liberalization of trade, and (2) some modifications in financial and monetary arrangements. Adequate adaptation of commercial policies and financial arrangements to the changed tendencies of the free world economy can come about only as the result of sustained consultation and negotiation. To facilitate continuing discussion and negotiation, consideration should be given to new institutional arrangements such as, for example, transformation of the present OEEC into a new organization including the United States and Canada as full members.

In the field of commercial policy, our objective of nondiscriminatory, multilateral trade has been persistently frustrated during the past 25 years by the inescapable fact of dollar shortage. Foreign countries have resorted to discrimination against American exports, chiefly through import quotas and currency inconvertibility, as a means of keeping their dollar disbursements within their available dollar resources. Although, as the dollar problem has eased, progress toward currency convertibility has been substantial, and some relaxation of import quotas against dollar goods has occurred, the disappearance of dollar shortage will not automatically assure the removal of long-established discriminations.

The reciprocal feature of the reciprocal trade agreements program, although of political value at home, also had limited actual significance in a dollar-short world. In the condition of dollar shortage which has generally prevailed since the passage of the original Trade Agreement Act in 1934, any reduction in American import barriers, and any resulting increase in foreign earnings of dollars, automatically increased our exports since foreign purchases of urgently needed American goods responded at once to any easing of the supply of dollars available to them. Thus, the expansion of our exports flowed automatically and promptly from the reductions in our import barriers, whether reciprocal concessions were granted or not. The reciprocal concessions which were obtained in trade negotiations were, in this sense, somewhat superfluous.

With the disappearance of dollar shortage, the connection between increased American imports and increased exports to foreign countries is much less direct and automatic. By the same token, the reciprocal feature of our trade agreements program now takes on a wholly new importance. Under present conditions it becomes of great importance, in future commercial negotiations, to use our tariff reducing powers as a real bargaining instrument to achieve the substantial trade liberalization which disappearance of dollar shortage has made possible.

One objective in these negotiations should be to facilitate the evolution of the European Common Market as an integrated, single market with a low external tariff. We should join actively with Western European nonmembers in pressing the demand for a low tariff, especially as the breakdown of discussions on the free trade area proposal suggests a need for an active American role in the negotiations. Since France and Italy have very high tariffs, Germany high tariffs and only Benelux has a low tariff, the broad formula for the common tariff proposed in the Treaty of Rome—an average of the present tariffs of member countries—would yield a highly disruptive degree of trade discrimination between members and nonmembers. An external tariff at any such level must be prevented. In these negotiations, the Western European nonmembers must also be prepared to reduce tariffs substantially.

A second urgent objective is to secure the further liberalization and, within a reasonable period, the complete elimination by Western European countries of their remaining quantitative import restrictions on manufactured goods. So long as these quantitative import restrictions remain in effect, currency convertibility alone remains of somewhat limited significance. With the "dollar shortage" justification for these restrictions no longer present, full compliance with the GATT's general rules against quantitative restrictions in nonagricultural products is called for.

In the matter of Western European agricultural protection, our objective should be to negotiate long-term agreement with the Common Market for a substantial relaxation of barriers in successive, moderate steps. The importance of this for our agricultural exports has already been emphasized. It should also be pointed out that gradual relaxation of agricultural protection would further strengthen the growth of real income within the Common Market.

In the financial and monetary field, there are three major areas where modification of existing arrangements requires consideration.

First, the present allocation of the financial burden of NATO defenses should be reconsidered in the light of the changing economic condition, balance of payments position and fiscal situation of its members. From the point of view of an economist, the present share borne by the United States appears somewhat high in relation to today's conditions. It is recognized, of course, that on this issue political and strategic factors may be decisive. Moreover, Britain's lack of success in her negotiations with West Germany on this matter is not particularly encouraging. Nevertheless, changes in economic and financial capacity of NATO members should be taken into account. It is even possible that the unity of the NATO alliance might be strengthened by a greater assumption of financial responsibility by some continental European member.

Second, some continental Western European countries have begun to participate in the financing of underdeveloped countries both through subscriptions to International Bank flotations and through extension of export credits. Much further expansion along these lines is now possible. Indeed, this provides a promising means of absorbing a part of West Germany's large and persistent balance of payments surplus. Apart from investment in French and Belgian territories in Africa, the financing of underdeveloped countries has been hitherto almost exclusively an American and British responsibility. Broader West German participation would be highly desirable.

Finally, with the elimination of inconvertible currencies and relaxation of import quotas, large swings in national balances of payments in response to speculative movements of funds, cyclical business fluctuations or other temporary causes must be expected. Although monetary and fiscal policy must today be influenced by balance of payments considerations, it may be taken for granted that neither the United States nor other advanced industrial countries will accept severe and sustained inflation or deflation to correct disturbances in the balance of payments.

The greatest danger inherent in the present situation is that essentially minor departures from equilibrium can become major crises through speculative movements of "hot money." The British crisis of 1957, in which the Bank of England's discount rate was raised to 7 percent, was essentially of this nature. Neither other Western European countries nor the United States can be confident of future immunity from crises of this sort. This is the most serious element of vulnerability in the more liberal trading and financing system which is now evolving.

I suggest that the Tripartite Monetary Agreement which finally evolved in the 1930's as a means of meeting this type of problem should be revived in new form, its membership to consist of the United States, Great Britain, and the Common Market countries. Through informal consultation on balance of payments developments and through concerted support of currencies subject to exaggerated, speculative pressure, the resources of this group of countries available for meeting speculative runs would be sufficient to forestall unnecessary crises. The International Monetary Fund alone does not meet this problem, partly because its resources might well be insufficient to meet the massive flights which can develop from one financial center to another, and partly because resort to the Fund is itself a crisis measure and a symptom of crisis. In situations of the type which Britain faced in 1957, the task is not to overcome a crisis, since the crisis should not have been allowed to develop. The problem, essentially, is to prevent such crises by supplementing present arrangements for international monetary cooperation. Without some supplementary arrangement among the financially important countries for concerted support and, if necessary, massive support of any major currency subject to speculative runs, the danger of further crises will remain present; with adequate supplementary arrangements of this sort, the speculative runs are unlikely to gain momentum and, in any event, can be easily overcome by concerted support of the currency under speculative pressure.

The CHAIRMAN. Dr. Scitovsky?

## STATEMENT BY TIBOR SCITOVSKY, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, BERKELEY, CALIF.

Mr. SCITOVSKY. Thank you, Mr. Chairman. I feel I have very little to add to Professor Despres' statement, with most of which I agreed; but I should like to stress just a few points.

One is that I think it is worth stressing that there is quite a lot of uncertainty as to how and how far the Common Market will go. Not only is it to come into effect gradually over a period of 12 to 15 years, but some of its most important provisions so far are very little more than statements of intention. I am referring specially to the harmonization of monetary and fiscal policies. I feel that this is very important, because if it is not carried out in the spirit as well as in the letter of the provisions, then balance-of-payments difficulties would arise, and they bring into operation escape clauses that may make the treaty very little more than dead letter.

I would also like to stress that I do feel that any economic disadvantages in the U.S. balance of payments that may result from the establishment of the Common Market are likely to be rather small as compared to the political advantages to us of the economic strength of our Western allies.

Perhaps I should say a few words about why I think that these economic disadvantages are likely to be small

I do agree with Professor Despres that the displacement effect is likely to be small. There are, of course, plans on the part of American business to establish subsidiaries within the Common Market area, there has been quite a lot of talk about the drain on U.S. capital resources that this would imply, and there has been qiute a lot of discussion of it here this morning.

I would like to point out, however, that numerically this drain may also be fairly small. We have statistics that show that actual American capital that went to the six countries for direct investment over the past 2 years was of the order of a hundred million dollars. In the first quarter of this year this went up to $72 million. The reason why this is so small is that there seems to be a tendency on the part of American businessmen to raise quite a lot of the capital in Europe itself. Again, statistics of the Department of Commerce show that, for example, in 1957—and I am told this is quite typical—very much more capital has been raised by American business within the European countries than the actual capital that has been moved out of this country into the European countries, and there is every reason to believe that this trend will continue.

Senator BUSH. Has that been raised over there by borrowing the money within the country or by selling capital stock?

Mr. SCITOVSKY. I think it has been largely by borrowing money over there. I think it is more borrowing than selling capital stock as far as I know. But I do not know for certain.

Mr. BALL. If I might just interject a point, again based on random and unsystematic observation:

I would suggest that a very considerable part of that has not been raised by American firms as such, but by partnerships of American firms and European firms. The normal pattern that seems to be evolving now is for an American firm to find a parnter who is already established in the Common Market—the European partner who makes most of the arrangements for obtaining local capital. While it may appear that it is being raised in aid of an American enterprise, it is usually for an American-European partnership that capital is acquired.

Senator BUSH. When you speak of partnership, you mean alliance rather than partnership in the pure meaning of the word?

Mr. BALL. No, the pure meaning of the term. The normal situation is that there is a 49 or 51 percent interest. You can buy one side or the other, and a certain amount of machinery is put in by the American side, equipment or perhaps patterns that are of value, and a certain amount of money goes into it. But, as I suggested earlier, I think that the big wave of American capital flow to Europe is not now, but perhaps 3 or 4 years from now.

These are beachheads of production that are being erected.

Senator BUSH. How would a partnership raise capital over there as distinct from a corporation?

Mr. BALL. When I say partnership—I am sorry, I misunderstood—it is normally some sort of corporate device, depending on the laws of the country.

The CHAIRMAN. Professor Scitovsky, would you continue?

Mr. SCITOVSKY. A further point that is often stressed is the increased efficiency of European industries that is likely to result from the establishment of the Common Market. I do believe there is very likely to be such increase in efficiency. But I should like to point out that an increase in efficiency is just one factor that may increase the competitiveness of European industry with American industry, both in the Common Market area and in this country and in third countries, and there are very many other factors. Of course, the most important is what will happen to the prices of European manufactures relative to American.

As Professor Despres has pointed out, and many other people have pointed out before, past experience does suggest that European prices have risen faster than American prices: in France, very much faster; in Germany and in Italy, a little faster; in the Benelux countries, just about at the same rate.

I personally believe that the establishment of the Common Market, if it is fully implemented, may well slow down this rise in prices, but I admit that this is a very bold guess, and it is very hard to tell.

However, I also feel that if you assume the worst—that prices indeed should rise more slowly in the European countries than in this country, and that this should indeed make European industries more competitive as compared to American industry—I am not really too much afraid of this leading to a chronic and constant export surplus of the Common Market countries and a corresponding drain on American reserves on the other side.

In the past, of course, it is perfectly true that the Common Market countries have built up very much their gold and foreign-exchange reserve. They raised it from about $4 billion in 1950 to $12.5 billion at the end of 1958, and we have been losing gold at the same time, which was just a counterpart of the same trend, from our point of view.

Most economists I believe have welcomed these changes, because we have always felt that for a long time in the past there has been a maldistribution of gold and foreign exchange reserves, with too high a concentration of them in this country; and some of this maldistribution still remains. In fact, this country's share in the world's external reserves is still twice as high as our share in world trade. As far as the Common Market countries are concerned, their share in the world's total external reserves is still about 10 percent below their share in world trade, and it seems reasonable on their part to wish to build up their external reserves to some kind of adequate level which, on this standard that I just mentioned, they have not reached yet.

But once they have reached something like an adequate level, I would contend that it is not in the interest of a country or group of countries to continue running an export surplus and building up external reserves. They do play much the same role in a country's economy as excessively large bank balances, non-interest-bearing bank balances, play in the economy of an individual person.

I think there is some evidence that people in these European countries are fully aware of this. They are aware of the fact that building up external reserves beyond some necessary minimum level is a luxury which they can ill afford, and running export surpluses of this type amounts to the unproductive uses of a country's savings. I do think that sooner or later they are very likely—and there are some indications of this—to feel that this is a time for them to increase investment. They should be able to increase investment, there are plenty of investment opportunities in the six countries, and the establishment of the Common Market is going to provide many more investment opportunities than they already have.

This, I feel, would also mean that simultaneously with increasing investment, it would also be in their interests to use their strengthened foreign trade position for the purpose of negotiating more liberal foreign trade policies and tariffs.

Professor Hallstein, the President of the Commission of the EEC, has indicated at the time of his recent visit to Washington that this was indeed the aim of the community. I think this makes perfectly good economic sense from the point of view of these countries.

I should like to add that perhaps it is unsafe on our part to rely on their recognizing such interests, but at the same time there still remains quite a lot of trade discrimination againset the United States, for example. We are still extending some aid to these countries, and I cannot help feeling that any country that is going on accumulating external reserves beyond some adequate standard is really showing that it is not making full and the best use of its resources. This would, I think, give us a very much stronger position morally in trying to persuade them to reduce whatever trade discrimination still remains against the United States.

I feel this is probably an important factor that should be borne in mind, and which I should just like to add to the various other factors that especially Professor Despres has mentioned earlier.

The CHAIRMAN. Thank you very much.

Representative CURTIS. Mr. Chairman, I have been trying to catch up a little. I am sorry I have been unable to be present on the previous days.

I have read these papers, and I think I am a little out of tune, at least I have been unable to grasp the significance of these papers on the question of the significance of the European Common Market to the American economy.

One question I would like to ask the panel is, Would not a test of the effectiveness of the European Common Market be to see what happens to the percentage of their foreign trade, the entire common market of trade outside of the Common Market, to their gross national product?

We start out with the six countries—Italy, France, Germany, and the Benelux countries—and all of them have a very high percentage of their foreign trade to their gross national product.

We could add to that or subtract from that figure the amount of trade that is listed as foreign trade which goes on between the six countries. So we have something to start from.

Would it be your thought, the panel's thought, that merely putting together this Common Market would lower the percentage of trade outside of the Common Market to its gross national product? Do you follow what I am trying to get at?

Maybe I can explain what I am thinking of in this respect.

The Boggs Subcommittee on Tariff and Trade were abroad discussing some of these economic problems with these various countries, and some of the economists there. One point that was constantly made was that although in the United States the percentage of foreign trade to its gross national product was very small, the absolute amount of that foreign trade was a tremendous factor in world trade.

I make the point that of course one reason the percentage of foreign trade to the U.S. gross national product was so small was that we did have a tremendous common market, but if we ever tried to measure the amount of trade that goes on within the United States between California, New York, and so forth, probably we would come up with as high percentage figure as Italy or France has.

So in trying to evaluate what actually does occur in this Common Market, it seemed to me that the use of the percentage of the foreign trade to their gross national product would be a way of finding out what has occurred or is occurring.

Is that thinking wrong or would someone comment on that?

Mr. SCITOVSKY. Mr. Chairman, perhaps I could quote a few figures here.

If you deduct the trade of the six countries with each other from their total foreign trade, then their combined foreign trade with the outside world is almost exactly the same figure in dollar terms as the foreign trade of the United States, at the same time that the combined gross national products are slightly over half of the U.S. gross national product.

Representative CURTIS. So their percentage of foreign trade to gross national product is almost twice?

Mr. SCITOVSKY. That is right.

Of course, it is quite true that we all expect some trade diversion as we call it. As a result of the establishment of the Common Market, we all expect that some of the trade the Common Market countries have with the outside world they are going to shift to each other. So we do expect an increase in inter-European trade.

Representative CURTIS. Which would mean possibly a decline in the percentage figure?

Mr. SCITOVSKY. If I may go on, it would certainly mean an increase in the absolute volume of trade among the Common Market countries. Whether it would also imply a decrease in the percentage figure with the outside world, this still remains to be seen. I think one must bear in mind that the Common Market countries are economically much less independent than is the United States. They are very much more dependent on importation of raw materials. Professor Despres, I believe, implied they are really more dependent also on imported food than we are.

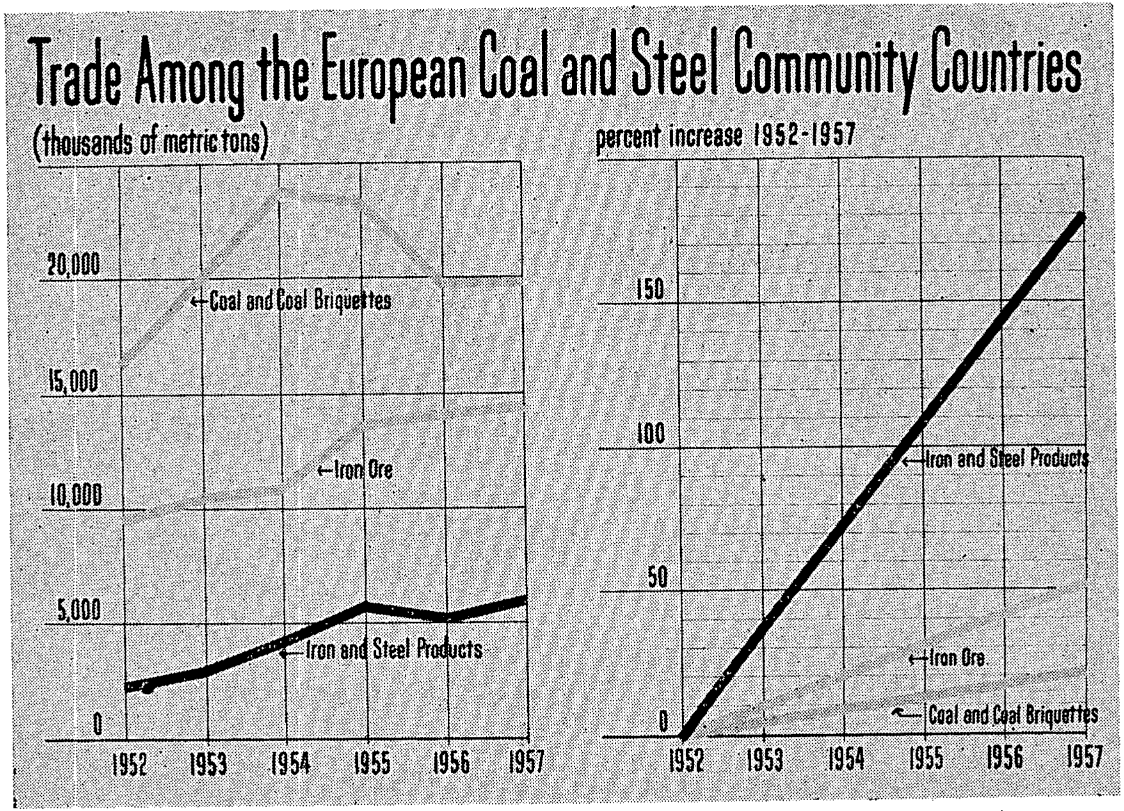
Representative CURTIS. That is the actual situation. Is that also a potential to look forward to?

Mr. SCITOVSKY. I think so.

We have a few instances of statistical evidence of increase in inter-European trade. This is true of the Coal and Steel Community, which Mr. Ball has shown on his chart.

Mr. BALL. This is a case, Mr. Curtis, where the Common Market for coal and steel went into effect in 1952 [indicating chart V]. The trade between countries within the Community in 1957 was 180 percent greater than in 1952.

CHART V


Trade Among the European Coal and Steel Community Countries
(thousands of metric tons)
20,000
15,000
10,000
5,000
0
←Coal and Coal Briquettes
←Iron Ore
←Iron and Steel Products
1952
1953
1954
1955
1956
1957
percent increase 1952-1957
150
100
50
0
←Iron and Steel Products
←Iron Ore
←Coal and Coal Briquettes
1952
1953
1954
1955
1956
1957

Representative CURTIS. Of course it would be hard to figure the other point that I was trying to compute, as to whether the trade, taking everything out of that as foreign trade, whether that has gone down.

I would suspect that it will. I would think that any time you put together a larger market, it would have a tendency to cut down the amount of trade outside that market. I do not know if that is so.

Mr. SCITOVSKY. May I add, though, what Professor Despres has been stressing, that the six countries are competive rather than complementary. They are all producing very much the same kind of things. The possible fact that the six countries are going to be one economy does not make them significantly more self-sufficient.

Representative CURTIS. I think it will tend to, though. I agree as to when you first put them together; but in order to try to figure out what effect it is going to have on the United States, which is the question here, what does putting them together do if they are not going to continue that way?

I would think it would tend to make it more of a less dependent bloc than it is when it starts.

Mr. DESPRES. If I may stick my own neck out on this, I would expect that as national income in the Common Market countries grows, the trade among the Common Market countries themselves will grow faster than their outside trade, and I would expect their outside trade not to grow as fast as their national income, either.

However, I would expect a net growth in their outside trade; and of all the things I have said, that last sentence is the one where I am really taking a chance, because you ought to look at some figures before saying it categorically.

But I would be willing to bet that there will be a net increase in the amount of trade with the outside world as the result of general economic growth in the Common Market. The reason is essentially the reason that Dr. Scitovsky gave; namely, that so far as the non-European world is concerned, the imports by the Common Market from the non-European world are mostly of complementary products, foods, and raw materials, and as their industry expands and as their real income expands, they will need to draw in more of these foods and raw materials.

The place where I am more than a little worried, as I have said before, is the effect on the outside Western European countries. But even so, I think that for outside trade as a whole, one can expect a rise, although in a declining ratio to national income.

Representative CURTIS. That would be my hunch. I am glad to hear you say that. The test that I would use would be the increase of a per capita gross national product within these six countries. Because that, I would think, is a good measure of the domestic market.

One other area that it seems to me is basic here—and talking again about the impact on the United States: We have been talking about these regional economic organizations, that they are really of developed countries. The European Common Market countries tend to have developed to the point where they are manufacturing rather than producers of raw materials.

What impact that will have on the so-called underdeveloped countries or at least those countries that do produce raw materials, is the other big question that comes to my mind.

I was very interested in our GATT negotiations, where apparently the United States was not willing to sit down and discuss the problem of developing the underdeveloped countries. What is going to happen with another big bloc of developed countries going together—I think you said, Doctor, you thought the absolute demand for raw materials would probably increase. But I wonder how the ratio would be. Would there not be a tendency, or is there not one now in such countries, to develop more raw material production within that country, just as there has been in the United States? We produce a great deal of our own raw materials.

Mr. SCITOVSKY. Mr. Chairman, I am afraid I do not know very much about this. I am aware of the fact though that there has been quite a lot of concern expressed in some of the raw-material-producing countries of the world, that the establishment of the Common Market would divert the demand of the Common Market countries to quite an extent, to their own dependencies.

I know that Ghana, for example, has been exporting tremendous quantities of cocoa to the Common Market countries, and they are very much concerned that this demand will be diverted to some African dependencies of, say, France. In fact, I know that this fact has been discussed greatly within the British Empire. It is a peculiar situation, that there was an unofficial conference held, I believe, in Palmerston, New Zealand, of British Dominion countries, and they seemed to be more concerned than Britain itself about the establishment of the Common Market and their being outside of it without any such arrangements like, say, the free trade area.

Representative CURTIS. You are putting your finger on exactly what I wanted to have a little discussion on.

On the empire concept, you had of course the raw-material countries with manufacturing countries in an economic bloc, the sterling bloc of the British Empire, while this Common Market development is an economic bloc of countries that are similar, that is, are all manufacturing, you might say, as opposed to raw material producing. It seems to me that it is going to bring about some new changes, maybe good; I don't know.

Mr. DESPRES. May I add a word on this?

I would say if you consider the underdeveloped countries as a whole, including the colonial territories of France and Belgium, if you consider this whole group of countries, I think one may say that this group, taken as a whole, will benefit doubly: First, greater growth in the Common Market countries means greater demand for their products; second, a better buy in industrial machinery for these countries that are trying to industrialize, is a help to them, too; so they benefit both on the side of their exports and on the side of the terms on which the kinds of goods they import are offered to them.

The real awkwardness here is that it is a part of the intention of the Common Market plan to foster especially the development of production in their own colonial territories. Here, if I may use the word, is a discriminatory feature of the arrangement that we ought to be interested in. It would be a pity if the colonial territories were too drastically favored at the expense of the newly independent countries in Africa and elsewhere. This is the kind of feature of the Common Market which we ought to be alert to, and to watch the development of these colonial policies is highly desirable. It is not desirable that it be of too discriminatory a sort.

This is the only point I wanted to make.

Representative CURTIS. Mr. Chairman, I will include by just asking one question, which was not mentioned in the papers, and this is for information:

How are the colonial possessions of the countries that are in the Common Market fitted into the Common Market?

Mr. BALL. I might answer that, Mr. Curtis.

There is a special provision of the treaty, that the territories which are specially tied to any of the six countries in the Common Market are given free access to the Common Market, but may themselves interpose some trade barriers to imports from the Common Market countries for a period of time in order to assist their development.

In addition to those territories, which are principally French West Africa, French Equatorial Africa, and the Belgian Congo (there are others) there is a treaty of association presently being discussed, and perhaps I should say discussed rather than negotiated, although negotiations are expected with Tunisia, which has become independent, as you know. It is very likely that there will be also a treaty of special association with Morocco. Since Algeria remains juridically a part of the French Metropole, it is treated as a part of the Common Market, for most purposes. This is most important with respect to the French Algerian Sahara, which has great potential natural resources under development at the moment.

Does that answer your question, sir?

Representative CURTIS. Yes, it does, thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator?

Senator BUSH. I have no further questions.

The CHAIRMAN. I want to thank the panel.

I think there is one factual point that we should clear up for the record. Reference has been made from time to time to the possibility that the Common Market might adopt a restrictionist policy in its external relations with countries outside the Commonwealth, and that possibly this could be reduced by negotiation.

I have thought that over the vast mass of commodities, the external tariff would be the arithmetic average of the existing tariffs.

I know there is a category known as category G, on which the tariff rates have not yet been established. This is the question: To what degree will the fixation of the external tariff be a mere matter of arithmetic? And to what degree will it be a matter of policy decision on the part of the Government?

Mr. BALL. There are certain special lists, as you probably know. Category G is the principal one.

The CHAIRMAN. As I looked at that list, it did not seem to me particularly imposing, unless I missed some commodities.

Mr. BALL. Principally chemicals; is that not right?

Mr. SCITOVSKY. Yes.

Mr. BALL. There are also lists of other commodities which are to be given special treatment. At the same time the Common Market is obligated to comply with the provisions of the GATT as well as with the provisions of the Treaty of Rome itself.

The estimation made, as I understand it, by the Commission, is that the net of the combination will turn out to be something less than the arithmetical average, because of the weighting.

The CHAIRMAN. Is that because Belgium and Holland will be treated with the same importance as France and Germany. They are low tariff countries, and therefore the arithmetic average will be less than the weighted average would be?

Mr. BALL. Yes; it is my understanding that the low tariff of the Benelux—Belgium, Holland, and Luxembourg, an economic unit of some 20 million people—receives the same weight in computing the arithmetic average of the Common Market's external tariff as the existing tariffs of France, Germany, and Italy, countries whose combined population is seven times as great.

The CHAIRMAN. What about about the so-called exempted commodities?

Mr. BALL. As mentioned earlier, there is the list G contained in the Common Market Treaty. The external tariff on the various commodities on this particular list is subject to negotiation between the six member nations of the European Community. In addition, each member nation may add further products to this list up to the limit of 2 percent of the total value of its imports coming from non-Community countries during the year 1956.

The CHAIRMAN. The British from time to time refer to these mysterious exempted commodities upon which it is possible that rates may be increased. Would that be accurate?

Mr. BALL. There is some possibility for adjustment as long as the overall standard is met. There are adjustments being worked out.

As you know, the external tariff has not finally been fixed. A committee has been actively working on it, and it is expected to come up with proposals soon. There will be adjustments. In some cases, the external tariff will be adjusted up, rather than down.

But, the overall standard will be met. The net effect will be an external tariff somewhat less than the exact arithmetic average.

The CHAIRMAN. Does anybody want to add a comment?

Mr. DESPRES. I am a little distressed by Mr. Ball's statement that the overall target will be met. I am not as well informed about this as he is. I had thought and hoped that all of the provisions in regard to the external tariff were subject to outside negotiation, and that it would be entirely possible, at least in terms of the agreement, to arrive at a lower external barrier than the formula provided.

Mr. BALL. That is precisely right. Let me make myself quite clear.

First, a theoretical external tariff must be established. A 10-percent reduction, not required by the treaty, was extended multilaterally on a most-favored-nation basis on the 1st of January to all member nations of GATT.

The CHAIRMAN. And a 20-percent reduction in quotas?

Mr. BALL. That is right, a 20-percent expansion of quotas. However, this 20-percent increase in quotas which went into effect among the six member nations of the Common Market on the 1st of January 1959, was extended only to member nations of the OEEC not in the Community and then, only partially. Actually, the Community offered the OEEC nations outside the Community 80 percent of the initial quota increase given to member nations, with the remaining 20 percent of the increase to be negotiated. Again, this move was not required by the Common Market Treaty but was done to reassure nonmember nations that the European Economic Community does not intend to pursue restrictive commercial policies.

The CHAIRMAN. Expansion, yes.

Mr. SCITOVSKY. I thought it was only extended to the Common Market countries, and some agreement with the OEEC.

Mr. BALL. Yes, on a negotiated basis. But as far as the tariff reduction is concerned, it was extended multilaterally on a most-favored-nation basis, and presumably will form a basis of part of the negotiations which are now being undertaken. I think the actual negotiations start in the fall of 1960, looking toward possibly as much as a 20-percent reduction under the authority given the President by the most recent Trade Agreements Extension Act.

The CHAIRMAN. I do not wish to belabor the point, and it is getting late, but are you implying that while they, let us say, get an overall reduction because of giving Holland and Belgium greater importance than their relative trade might justify, nevertheless, in certain specific commodities, they might get a tariff which would be in excess of the arithmetic or the weighted average?

Mr. BALL. I think there will be some adjustment upward in some tariffs, certainly. The tariffs of the Benelux countries, as the earlier chart indicated, will tend to——

The CHAIRMAN. I understand that, but I mean the general average. Will there be any change where the external tariffs will be higher than the arithmetic average of the specific countries?

Mr. BALL. No. The external tariff cannot be higher than the arithmetic average of tariffs existing on January 1, 1957, in the four customs areas. However, it is possible that the negotiated external tariffs on commodities in list G may be higher than the arithmetic average of tariffs existing on these specific products on the first of January 1957.

Do you agree with that, Professor?

Mr. SCITOVSKY. I am afraid I do not know.

The CHAIRMAN. Mr. Curtis?

Representative CURTIS. I think, too, the list becomes very important, because they could up tariffs on items in which the United States, for example, would trade, and grant a lowering in areas where the U.S. products were high.

Mr. BALL. It is not possible to do this because there will be a common external tariff.

Representative CURTIS. Has a study been made to see what the list is?

Mr. BALL. It relates, Mr. Curtis, primarily to raw materials.

Representative CURTIS. Would that go up or down?

Mr. BALL. As I believe I mentioned earlier, this particular list of commodities, known as list G, is the sole exception to the arithmetic average formula. Thus the negotiated external tariffs on products on this list could be higher than the arithmetic average of the individual tariffs on these items on January 1, 1957.

My recollection, although I have not looked at the treaty in this connection or at the list for some time, is that none of these commodities is of particular interest to the United States.

The CHAIRMAN. Mr. Despres?

Mr. DESPRES. There is a general point I think ought to be made.

Whenever you get figures for an average reduction in tariff, there tends to be a kind of a bias in the results, for the simple reason that the country reducing tariffs or the group of countries reducing tariffs will reduce most those rates where the existing degree of protection is kind of redundant, anyway, and naturally, will make the smallest reduction where it hurts some domestic industry. So without analyzing this particular case, I think it is a kind of safe a priori judgment that this applies in general.

The CHAIRMAN. There are no further questions. We want to thank you gentlemen. Your statements were very good. I want to express our appreciation.

Mr. Scitovsky, your written statement will be placed in the record at this point.

(The statement referred to follows:)

STATEMENT BY TIBOR SCITOVSKY, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, BERKELEY, CALIF., ON THE PROBABLE EFFECTS ON THE U.S. ECONOMY OF THE EUROPEAN ECONOMIC COMMUNITY

I should like to preface my remarks by saying that they are highly speculative. The nature of the subject makes this inevitable. The treaty establishing the European Economic Community has hardly come into force; and it is hard to predict the extent to which the letter and the spirit of its provisions will be carried out. It is even harder to predict the consequences on the U.S. economy of these hard-to-predict changes in the economies of the Common Market countries. For present purposes, I shall assume that all provisions of the treaty will fully go into effect as planned, including those that so far are little more than statements of intention.

The European Economic Community, established by the Rome Treaty of 1957 and effective beginning January 1, 1959, is regarded by many as one step toward the complete political and economic integration of the six countries (Belgium, Western Germany, France, Italy, Luxembourg, and the Netherlands). It provides for the progressive abolition of all trade restrictions among the member countries, for the unification of their tariffs and trade policies toward the outside world, for the greater mobility of their labor and capital resources, and for some degree of coordination of the member countries' monetary and economic management. All this is to be accomplished gradually, over a 12- to 15-year period. To date, the only one of its provisions already in effect is a 10-percent reduction of tariffs and a 20-percent liberalization of import quotas on trade among the member countries. The treaty sets up a detailed, if flexible, timetable for the further reduction of import restrictions among member countries; it is very much less specific on the other provisions, especially on the one concerning the coordination of monetary policies. And yet, this last provision is, in my opinion, among the most important. For without some such coordination, balance-of-payments difficulties are almost certain to arise, and they would bring into operation escape clauses that could suspend almost every provision of the treaty. As I stated earlier, however, I shall assume in the following that the treaty will be fully implemented.

In that case, the economies and markets of the six countries would be completely integrated by the early 1970's. In other words, there would be a common market comprising an area one-seventh that of the United States, and whose present population is almost as great as ours but whose combined gross national products are now only slightly over half that of the United States. The creation of such a large integrated market is expected to make possible, and through increased competition encourage, the use of better productive methods in the member countries. This would enchance their productivity and raise their standards of living, which today are less than two-thirds of this country's, though growing at a rate faster than ours.

How much their productivity is likely to increase, or how much faster it is likely to grow, is impossible to predict with any confidence. All one can say is that there will be improvement, possibly substantial improvement, and that such improvement will not result solely or even primarily from the diversion of trade from third countries.

What effect will all this have on the United States? First and foremost, it is clear that an improvement in the economic position of our allies is of advantage to us. Until very recently, the U.S. Government found it worthwhile to extend economic aid to these countries, despite the fact that every dollar they received meant the sacrifice of a dollar to us. An improvement in their economic position resulting from the formation of the Common Market will not involve this dollar-for-dollar relationship, partly because the United States would share with other third countries any possible losses inflicted on their trade position, partly because, as argued earlier, such losses are bound to be smaller than the gains to the Common Market countries if, indeed, there are any losses at all. These considerations must form the background against which all further discussion firms in many parts of Europe, the Far East, and Latin America.

When we come to examine the possible effects of the EEC (European Economic Community) on the U.S. economy, we must distinguish between its effects on individual business firms and its effects on our balance of payments, because the two are not always similarly affected. As regards the balance of payments, it will be improved on some counts, worsened on others; and it is difficult to say which will prevail. The immediate effects are likely to be unfavorable; but in the long run, when the Community is fully established, the favorable effects may well offset the unfavorable ones or may even outweigh them.

The most direct and immediate effect of the Common Market on the balance of payments will be the diversion of some of the member countries' demand from American and other foreign exports to the exports of fellow-member countries. This comes about as tariffs and quotas on imports from fellow members are lowered while restrictions on imports from other countries are retained. Such trade diversion and a resultant reduction in U.S. exports to the Common-Market countries is almost certain to happen but is not likely to be very important. The products affected are only those that the European countries can produce themselves in sufficient quantities, which means primarily manufactures and coal and steel. In 1958, total U.S. exports to the six countries amounted to less than $3 billion; and only $1.5 billion of this was coal and steel and manufactures. How great a part of these vulnerable $1.5 billion U.S. exports will be affected is impossible to estimate without detailed analysis. A rough estimate (made some time ago by Professor Verdoorn of the Rotterdam School of Economics) of the reduction in Common-Market imports from all outside countries, when applied proportionately to the U.S. share, would give a $200 million reduction in U.S. exports. This is a very crude and rough guess but will serve to show the approximate orders of magnitude involved.

Many American business firms, anticipating stiffer competition from, say, German firms in France and from French firms in Germany, are laying plans to meet this threat by establishing subsidiaries within the Common-Market area itself. From their point of view, this may well be no less or even more profitable than the continued export of U.S.-made products; but it would not offset the effects of diminished U.S. exports on the U.S. balance of payments. Indeed, the export of capital implied by the establishment or buying up of European subsidiaries would constitute a further drain on our balance of payments; although the sums involved under this head again are not very great. The net flow of direct capital investments from the United States to the six countries was $97 million in 1957, $115 million in 1958 and $72 million in the first quarter of 1959.

Another and very minor factor capable of affecting U.S. exports is the projected replacement of the member countries' tariffs by a uniform Common-Market system of duties on imports from the outside world. The unified tariff of the EEC is to be the arithmetic average of the present tariffs of the member countries, which means that high-tariff countries like France and Italy will have lower tariffs, while a low-tariff country like Western Germany will have higher ones than at present. For example, the unified tariff on U.S. grinding machines would be 11¼ percent as against the 20 percent now levied on them in France and the 15 percent tariff imposed in Italy; whereas the unified tariff on U.S. hosiery machinery would be 15½ percent as against the current 6 percent duty levied in Germany and Holland. Such changes in tariff rates will affect the composition of U.S. exports but are not likely to make much difference to its total volume.

More important, potentially, in its effects on U.S. trade than the EEC's tariff and quota policies is the enhanced efficiency of European industries likely to result from the larger size of the Common Market. It is generally feared that this will turn European producers into considerably more formidable competitors of American industry, in Europe, in third countries, and in the American market itself. Even today, before the Common Market has had time to exert its influence, European industries are already outcompeting American firms in many parts of Europe, the Far East, and Latin America.

Increased efficiency, however, renders an industry more competitive only if it lowers prices. If the increase in productivity is accompanied, as it so often is, by a proportionate increase in wages and other earnings, prices remain unchanged. If this should happen in the EEC, not only would their exports fail to rise but instead the higher income of Common Market consumers would raise their demand for imports, among them U.S. imports. An increase in productivity therefore can affect the balance of payments either way, depending on whether it primarily lowers prices or raises earnings.

This in turn depends largely on the bargaining power of labor unions, the pricing policies of business, and the fiscal and monetary policies of governments. In other words, productivity is only one among the many factors that determine relative price levels and with it relative competitiveness. The crucial question is whether inflationary trends will be smaller in the Common Market countries than in the United States. This is a difficult question to answer. Past experience shows faster price increases in the Common Market area than in the United States—very much faster in France, a little faster in Germany, Italy, and Holland, and a little slower in Benelux. Establishment of the Common Market, however, may well change the basic conditions for all this. My guess, though a very tentative guess, is that, for a while at least, prices in the EEC may well stay lower and rise more slowly than in the United States. The increase in competition among the member countries likely to result from the integration of their markets should exert a powerful downward pressure on prices, especially in the beginning and before labor unions begin to form supranational bargaining units; and the somewhat tougher fiscal policies of the new French Government also point in this direction.

This view seems to be shared by many American businessmen. For plans to establish subsidiaries within the EEC are being laid not only by firms that fear the closing of the Common Market to their exports but by many others as well. They want to benefit by the combination of low European wages and the scope for efficient large-scale production which, in many fields, will be opened up for the first time by the creation of the EEC. They hope to sell their European-made products not only within the Common Market itself but in third markets and the United States as well. American firms, with their established goodwill and distribution and servicing network within the United States, are in the best position to import European-made products into this country; and if the development of the EEC does increase European exports to the United States, American-owned firms may well be among the main beneficiaries. The importation into this country of English Fords and the General Motors-made German Opel car are already existing examples of this; and there are indications that electronics, office machinery, chemicals, and consumers' appliances are among the American industries most interested in setting up subsidiaries in the territory of the EEC.

If these expectations are correct and price and cost levels within the EEC remain lower or advance more slowly than in the United States, then Common Market producers would be able to encroach upon many of the markets of American producers, and improve the balance of payments of the Common Market at the cost of that of the United States. I doubt, however, that it is in the interest of the Common Market countries to let such a situation continue for long. Indeed, I would argue that the EEC is more likely, in the long run, to use its improved foreign-trade position to negotiate from a position of strength for an all-round lowering of tariffs and generally for freer and more international trade. This was indicated in the public statements of Professor Hallstein, President of the Commission of the EEC, during his recent visit to Washington; and it makes good sense from the point of view of the economic self-interest of the EEC and its member countries.

The countries of the EEC have steadily improved their foreign-trade position over the past few years. They raised their gold and foreign-exchange reserves from $4 billion in 1950, to $12.6 billion by the end of 1958. During 1958 alone, they added $2.5 billion to their gold and foreign-exchange reserves, while we lost $3.3 billion over the same 12 months' period.

These changes must be welcomed, because they help to correct a longstanding maldistribution of the world's gold and foreign-exchange reserves; and some of this maldistribution stil remains. Even today, despite our losses and Western Europe's gains, our share in the world's gold and foreign-exchange reserves is still twice as large as our share in world trade; whereas the share of the Common Market countries is still some 11 percent below their share in world trade. One may expect therefore that these countries would wish to add further to their external reserves. Indeed, having suffered so very long from the inconvenience and humiliation of inadequate reserves, they may well wish to build up an exceptionally strong reserve position.

Nevertheless, a time will come, probably in the not too distant future, when they will consider their reserve position adequate and feel that continuing their export surplus and adding further to their gold reserves would be not only unnecessary but a costly and wasteful luxury. For a country to hold too large reserves is just as wasteful as it is for an individual to keep too much money on a non-interest-bearing checking account; and the Common Market countries are not so well off that they could afford such luxury. An export surplus constitutes savings that, instead of being productively invested, are being hoarded in an unproductive way. People in the countries of the EEC are supremely conscious of the need and use for investment to expand their economies; and the establishment of the Common Market will provide plenty of additional opportunities for new investment. It is reasonable to expect therefore that national governments and the EEC authorities alike will wish to encourage such investment and to accept the elimination of their export surplus as the cost of additional investment.

If the Common Market countries do use their improved economic position to step up investment, their demand for imported capital equipment, especially U.S. equipment, is bound to rise; just as the increased income of consumers in these countries is bound to raise their demand for imported consumers' goods. One must recall in this connection that the EEC now is and probably will remain much more dependent on trade with the outside world than is the United States; and for this reason, too, the Common Market countries can be expected to use their stronger foreign trade position for negotiating a general easing of international trade. In the meantime, however, American industry may well face stiffer competition in world markets and find itself under increased pressure not to raise prices.

The CHAIRMAN. The meeting tomorrow morning will be in this same room at 10 o'clock. The discussion will be the subject of "The Significance of Changes in the Underdeveloped Countries for the American Economy." The witnesses will be:

Reynold E. Carlson, professor of economics, Vanderbilt University.
Raymond F. Mikesell, professor of economics, University of Oregon.
Simon Rottenberg, professor of economics, University of Chicago.

The committee stands adjourned until 10 o'clock tomorrow morning.

(Whereupon, at 12:25 p.m., the committee recessed to reconvene at 10 a.m., Thursday, July 2, 1959.)

# EMPLOYMENT, GROWTH, AND PRICE LEVELS

THURSDAY, JULY 2, 1959

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to adjournment, in room F-63, the Capitol, at 10 a.m., Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senator Douglas and Representative Bolling.

The CHAIRMAN. Gentlemen, we appreciate very much your coming this morning. The subject, as you know, that we have for discussion is "The Significance of Changes in the Underdeveloped Countries for the American Economy." We have three distinguished economists this morning to discuss the subject: Prof. Reynold Carlson, of Vanderbilt University; Raymond Mikesell, of the University of Oregon; and Simon Rottenberg of the University of Chicago.

Do yo have any preference as to the sequence in which you should testify?

(No response.)

The CHAIRMAN. Does one of you have more of a factual statement than the others?

(No response.)

The CHAIRMAN. We will begin with Professor Carlson then.

## STATEMENT OF REYNOLDS E. CARLSON, PROFESSOR OF ECONOMICS, VANDERBILT UNIVERSITY

Mr. CARLSON. The drive for economic development is one of the phenomena of the postwar period in practically all the countries of the world outside of Western Europe and Canada. These pressures are rooted in part in the economic aspirations of countries—some of them formerly colonial countries—which feel they should have some economic counterpart to their new political freedom. There is a rising awareness in some cases that some notion of improvement in the standard of living is associated with some improvement in political stability. So economic development is the battle cry of the postwar period in most countries of the world. In fact many governments have come to power by popular vote or by revolutionary methods, and inevitably the economic development plank is foremost in their advent to power. In many countries, a sense of urgency is given to the problem by the enormous population pressures that we all know about. Some of these governments then assume the role of economic leadership.

The process of growth in these various countries impinges on the U.S. economy at various points. Here let me be fairly general and leave it to my colleagues to fill in more of the material.

The first sector where the U.S. interests are directly affected is the trade sector.

On the export side of U.S. trade, it has been the record of a century or more of economic history that trade is best with the developed countries. The more developed you are, the better are your trade prospects; the better your customers, the more your development. In the last decade (1948–57), for example, total U.S. trade, both imports and exports, increased by $14 billion. Of this, 60 percent was with the industrial areas, Europe and Canada, and 40 percent with the underdeveloped areas. Apparently, the more development you have, the better market you offer.

On the import side, the United States is becoming increasingly dependent on raw materials to maintain its industrial system. Of our principal suppliers in 1957, three-fourths of our raw materials came from the so-called underdeveloped regions of the world and only one-fourth from Canada and Western Europe. From the point of view of economic development, this means opening up new resources, new mineral deposits, which increase the availability of raw materials to the U.S. economy. At the same time that the availabilities are being increased, new techniques are being developed which, in many cases, will reduce the cost of the raw materials coming to us, improving thereby our own productive prospects.

Along with this is the second area in which the U.S. interests are directly affected. This is in the area of capital development abroad, both of official capital and of private capital. Again, just for a single benchmark look at the last decade: Total U.S. capital invested abroad increased by about $18 billion. Over half of this, 51 percent, went to the underdeveloped areas and something less than half went to the more industrialized areas. As markets are growing and population increasing in these underdeveloped areas, the prospects for profitable investments by the United States are opening up on all fronts. One of the interesting variations in recent years is the disposition of American manufacturers to locate their productive capacity inside other countries, thereby making it possible for them to get around some of the trade restrictions, quotas, and tariffs that have had the effect of retarding the rate of U.S. exports to these countries. By setting up capital equipment and productive capacity inside the country, the market for U.S. goods is being assured.

In this connection and also with respect to the prospects of sharing in the growing markets in these underdeveloped countries, one big problem is arising. That is the prospect of the United States standing up under the competition of industrial exporters in Western Europe. The evidence is by no means clear, but it appears that in the last decade, and surely in the last 5 or 6 years, prices of U.S. manufactured exports have risen at a faster rate than those of some European countries, particularly faster than those of Germany and Italy. Perhaps France and Britain have not increased their industrial export prices quite as much. It remains to be seen, therefore, whether or not the United States can continue to maintain its share in this new growing market for capital goods in the face of price and quality competition from European producers.

The population problem in many of the underdeveloped countries is, of course, a well known and enormous one, but people are also markets. As economic development proceeds, income levels will rise, even modestly, and many of these countries in their push for industrialization are allocating more of their capital to industry and less relatively to agricultural development. It seems possible, therefore, that many of these underdeveloped areas will be increasing markets for foodstuffs. Yet, we all know that relative to the world as a whole the United States has an enormous comparative advantage, an enormously efficient plant for agricultural production. So the population growth, plus the pressures to industrialize in these countries, means, in many ways, an increasing market for U.S. agricultural commodities over the next few years.

Finally, the higher income levels which these countries will be gradually achieving over the next decade or two may make it possible for some of them to make small but increasing contributions to the common pool of resources for the mutual security program. In fact, one might think that mutual security could be made more mutual during the next decade or two by broadening the base from which these resources have to be drawn.

In summary, there is the trade aspect, the capital aspect, the agricultural market aspect particularly, and finally the small but growing prospect that the underdeveloped areas will be able to pull more of their weight in the mutual security program in years to come.

Thank you.

The CHAIRMAN. Thank you, Mr. Carlson. Your complete written statement will be included in the record at this point.

(The statement referred to follows:)

STATEMENT BY REYNOLD E. CARLSON, PROFESSOR OF ECONOMICS, VANDERBILT UNIVERSITY, ON THE SIGNIFICANCE OF CHANGES IN THE UNDERDEVELOPED COUNTRIES FOR THE AMERICAN ECONOMY

The drive for economic development which has become a major goal for the underdeveloped countries of the world has far reaching consequences for the American economy. The pressures for economic development have emerged most conspicuously since the end of World War II and are rooted partly in the economic aspirations of former colonial countries for a rising standard of living and partly in the growing awareness that political stability and the maintenance of some degree of freedom are associated with an improvement in their levels of living.

In many underdeveloped countries new governments have come to power on a wave of popularity or by the revolutionary route. One strategic plank in the political platform of almost every party in these countries today is the idea of economic development, sometimes at almost any cost. These new governments have in many cases been obliged to assume the role of economic leadership, and many plans and programs are being made. A sense of urgency is introduced by the pressures of expanding population in almost all of the underdeveloped countries.

In the process of growth, changes are taking place which impinge on the American economy at several points, presenting both problems and opportunities. Economic development brings about structural changes in an economy which are reflected in the magnitude, direction, and composition of its foreign trade. New resources are being opened up which in some cases compete with and in other cases complement the resources pattern of the United States. Population growth can mean expanding markets for American products, and especially agricultural products which may be in surplus. The widely accepted view that industrialization is the hallmark of economic development is inducing many countries to allocate their limited resources in this direction, often according lower priorities to the expansion of agriculture. In some countries the pressure for economic development is accompanied by varying degrees of nationalism, but there are many cases in which the investment climate has substantially improved. This offers opportunities for direct investment of American capital in a wide range of enterprises abroad, attracted by the growing markets and the prospect of profits that are reasonable in the light of the risks undertaken.

Finally, the economic growth of the underdeveloped countries may eventually lead to a reduction in the cost of mutual security to the United States. The time may soon be approaching when these countries may be able to make an increased contribution in the pooling of resources for the common end of assuring mutual security.

It now remains to examine briefly the significance of each of the changes noted above. With respect to the structure of foreign trade, it has long been recognized and demonstrated by a century of history that economic development means larger incomes and a larger volume of trade. In the brief period 1948–57 total U.S. foreign trade (imports and exports) increased by $14 billion, of which 62 percent was with Western Europe and Canada, while 38 percent was trade with the rest of the world—the underdeveloped areas. Evidently the more developed regions prove to be the better markets.

The composition of trade is also influenced by the development process. For some countries that are already well launched upon the development path, such as Brazil, India, or Japan, the volume of consumer goods imports tends to decline while the volume of raw materials and fuel, spare parts, and capital equipment imports have substantially increased; this increase has been greater than the decline, if any, in the trade of final products destined for direct consumption. Numerous illustrations of this change could be cited. In the case of paper and pulp, for example, the Latin American region is considered to be a deficit area and relies heavily on imports of newsprint and other paper products. But there are resources of timber in some coutries such as Chile and Brazil which are providing the basis for a new industry. The equipment for this industry is coming from American machinery manufacturers, and technical assistance is being provided by these same firms for the construction and operation of new paper and pulp mills.

The prospects for expansion of U.S. exports in the form of capital goods and equipment depend upon the ability of the United States to remain competitive in the world market. The fear is sometimes expressed that the United States is pricing itself out of the market," but on the other hand the entry of U.S. goods in many countries is restricted by quotas and exchange controls. Nevertheless U.S. exports are encountering increased competition which shows up in the substitution of Western European exports of manufactures for U.S. exports in third markets. Thus from 1952 to 1957 Western Europe's share of the combined export of manufactures to the underdeveloped countries rose from 64 to 68 percent.

While the evidence is by no means clear that we have priced ourselves out of world markets, we may be reaching a turning point. The U.S. share of world exports (excluding military goods) in 1958 is roughly 15 percent below the levels of 1950 and sets a new low. With respect to world trade in manufactures the U.S. share dropped to 23 percent in 1958 after running higher than 25 percent in the 2 previous years. The total value of manufactured goods exported by Great Britain, Germany, France, Belgium, and Japan rose between 1957 and 1958, while the total value of these exports by the United States declined. If this is the beginning of a trend, the opportunity for expanding trade in the underdeveloped coutnries cannot be taken for granted. Nevertheless with worldwide economic growth, U.S. exports will continue to rise by substantial amounts despite the growing competition from the industrial nations of the West. Even if the relative share of the United States does not increase, the absolute level of trade will increase over the years.

On the import side, the U.S. economy stands to gain substantially from the growth of the underdeveloped countries. In 1957 approximately 55 percent of U.S. imports were primary commodities, of which coffee represented nearly 20 percent, followed by petroleum products, ores, and nonferrous metals. The growth of the U.S. industrial system will make it increasingly dependent on these foreign sources of supply. For example, bauxite imports, already four-fifths of total supply, may be expected to increase twofold and threefold by 1970 to meet the expected growth in the aluminum industry. Again in 1957 manganese and chrome imports supplied about 50 percent of U.S. requirements, and with expansion of the iron and steel industries these imports may increase another 40 percent in the next 10 years. Copper, zinc, and mercury imports range from 35 to 55 percent of the U.S. reuirements. In some cases the United States has shifted from a net exporter to a net importer and from a low-cost producer to a marginal producer; the latter position is sometimes maintained only at the cost of restrictive quotas and tariffs.

The principal U. S. suppliers in 1957 were—

| | Percent |
|---|---|
| Underdeveloped areas: | |
| Latin America | 51.7 |
| Asia | 13.8 |
| Africa | 9.4 |
| Total | 74.9 |
| Other areas: | |
| Canada | 18.3 |
| Western Europe | 6.4 |
| Soviet bloc | .4 |
| Total | 25.1 |

It seems evident that the anticipated growth in the underdeveloped areas—and the opening of new natural resources—will increase the availability of raw materials as well as lower the cost to the U.S. industrial importer.

Rapid population growth, especially in those countries that are industrializing, means growing markets for U.S. primary commodities (foodstuffs) as well as machinery and equipment. Take, for example, countries like India and Brazil. Their population is growing by large annual increments, and the industrialization process is taking up a large share of their capital resources which might otherwise have gone into agricultural development. Consequently they may become increasingly important as basic commodity importers. At the turn of the century India, for example, was actually an exporter of wheat, but now approximately one-fourth of her imports consists of foodstuffs and primary products, with wheat and flour the leading commodity. The expected increase in U.S. imports of raw materials noted above will provide the dollars these countries need to purchase increasing quantities of U.S. foodstuffs.

The opportunities for U.S. private direct investment abroad are also linked with the growing markets in the underdeveloped regions. As the pace of development increases, gradually rising income levels to be found in these countries will attract U.S. capital. Comparing the period 1946–57, U.S. direct investment abroad increased from $7.2 billion to $25.3 billion, an increase of $18.1 billion. Of this increase, 51 percent went to the underdeveloped areas, 32 percent to Canada, and the remaining 17 percent to Western Europe. Direct investment of this character not only increases the demand for American equipment but, by locating productive capacity inside the boundaries of other countries, the American producer can avoid the restrictive effects of tariffs and quotas which otherwise tend to shrink the market for American goods. At the same time, all investment abroad helps to raise income levels in those countries; the additional purchasing power created by expanding production will spark an increase in demand for a wide range of commodities produced in the industrialized countries. To the extent that the United States can meet foreign competition from other industrialized countries in these markets, as noted above, it may expect to share in the increase in volume of business with these countries.

Finally, the higher income levels which the underdeveloped countries hope to achieve over the next decade or two will increase their capacity to contribute to programs of mutual security. The major burden will continue to rest upon the United States and Western Europe, but the contributions which the underdeveloped countries may be able to afford are by no means negligible. The time may come before too long when mutual security can be made more mutual by broadening the base from which the necessary resources can be drawn.

The CHAIRMAN. I will have to have a conference with certain representatives of the administration who are in the room. I am going to ask Congressman Bolling if he will take the chair.

Representative BOLLING. Have you completed your statement, sir?

Mr. CARLSON. Yes.

Representative BOLLING. Next, Mr. Raymond F. Mikesell.

## STATEMENT OF RAYMOND F. MIKESELL, PROFESSOR OF ECONOMICS, UNIVERSITY OF OREGON

Mr. MIKESELL. Thank you, Congressman Bolling.

I would like also to summarize my prepared statement.

First, I would like to say that I do not believe that the developments which are likely to occur in less developed areas over the next couple of decades are likely to be of major significance for employment, growth, and price levels in the United States, provided we continue to have access to them for supplies. I do feel that developments and policies in the United States and Western Europe will have tremendous significance for these countries and their economic growth.

Our exports to these nonindustrialized countries will, of course, grow over the next couple of decades. I do not think that they will grow at the high rates which were experienced in the decade ended 1957, for reasons that I will mention in a minute.

The pattern of our exports to these countries, I am sure, will also change. For example, these countries will probably become relatively self-sufficient in textiles and in a large number of other consumer goods items, and perhaps in a number of producer goods items as well. I saw a recent projection by the secretariat of the Economic Commission for Latin America the other day which showed that the Latin American countries as a group expected or planned to become self-sufficient over the next 20 years in textiles and in agricultural commodities. But this same projection showed that they expected to increase very substantially their imports of machinery and automobiles.

Both the rate of economic development and our exports to the less-developed countries will depend in large measure upon the economic policies of the United States and Western Europe. Experience has shown that development progress is very closely tied to imports and to the rate of import growth by developing countries.

Over the past 20 years the nonindustrialized countries—excluding Japan, Western Europe, and Canada—combined increased their annual volume of imports by about 104 percent. But their annual export volume rose only about 40 percent over 20 years. If we exclude petroleum, their export volume to the rest of the world, to the industrialized countries, rose less than 20 percent. This is less than 1 percent a year. I think this is significant.

The 100-percent increase in their volume of imports over the past 20 years has been made possible in considerable measure by an improvement in their terms of trade; that is, by the fact that their export prices were rising faster than their import prices, the prices of the things they bought. Also, of course, capital imports and foreign aid played an important role, and some countries, like India and Egypt, had large sterling reserves which they drew down after the war to help finance a larger volume of imports than exports.

These are nonrecurring items. I do not look for another terms-of-trade windfall on the part of the less-developed countries. I think it is rather unlikely that this will occur. As a matter of fact, terms of trade for the nonindustrialized countries have been falling since 1954.

This analysis, I think, raises the question of how these countries are going to finance a high rate of growth of imports in the future, which I believe is quite essential to their economic growth.

Considering U.S. imports from the less-developed countries, there has really been little increase in the dollar value since 1951. If we exclude petroleum imports by the United States, it is interesting to note that U.S. imports from the nonindustrialized countries were substantially lower in both 1957 and 1958 than they were in 1951 and 1952. On the other hand, U.S. exports to the less-developed countries, which were $6.2 billion in 1951, were nearly $8 billion in 1957, dropping down about a billion dollars in 1958 to around $7 billion.

Recently, some projections have been made by the secretariat of the General Agreement on Tariffs and Trade organization, projections of net imports of primary products by Western Europe and by the United States and Canada taken as a unit, from the less-developed countries.

I think these projections are very interesting. I do not think they are too useful as far as projections go, because of the wide range between the optimistic and the pessimistic estimates—that is, the high and the low rates of increase of our net imports of primary products from the less-developed countries is from over 60 percent over the next 20 years to only 12 percent.

The interesting thing is that the difference between the high and low estimates in these projections depends very largely on the assumptions which are made by these specialists regarding the agricultural policies of the United States and Western Europe. If, for example, Western Europe seeks to limit its dependence on agricultural imports from the rest of the world through protective devices, and if the United States increases substantially its net export surplus of grains and cotton, and certain other agricultural commodities, the expansion of exports by the less-developed areas will be quite limited. It will be limited very largely to their expansion of exports of minerals, petroleum, and tropical foods.

Considering the fact that the less developed countries increased the volume of their imports by over 50 percent, just between 1950 and 1957—in the case of Latin America there was a 60-percent increase in the volume of imports—and taking into account the past relationships between import growth and economic growth generally, I think it is rather unlikely that the less developed countries can maintain satisfactory rates of growth unless their imports increase at something like 2 to 2.5 percent per year over the next decade or two.

This means that over the next 20 years these countries must increase their imports by something like 60 percent over current levels. According to current projections, this will not be very difficult for countries exporting mainly fuels and minerals, but for countries exporting chiefly agricultural commodities there may be great difficulties, largely depending on the agricultural policies of the industrialized countries.

But if these countries cannot export enough to buy the imports they need for growth, why can we not fill the gap with capital exports, the gap between their import requirements and their exports? Of course, we are doing this now, but loan capital and private investment cannot continue indefinitely to fill the gap between rapidly rising imports on the one hand and slowly rising or stagnating exports on the other. The capacity to service increased loans and foreign investment depends upon a rising level of export earnings.

Suppose, just to take a very simple example, that a country borrows $100 million per year at 5-percent interest, with loans amortized over 20 years, that is, 5 percent a year. At the end of 12 years, service charges on the capital already received will be equal to the annual new capital inflow; that is, $100 million a year. After 20 years the debt service will amount to $150 million as against the annual $100 million inflow that we have assumed.

Obviously, at the end of 12 years, export earnings must have risen by at least $100 million, unless import requirements have fallen by that amount; but this is rather unlikely. The more likely thing is that import requirements will have risen substantially above the original gap to be filled by capital imports, so that foreign exchange earnings must have increased sufficiently to provide for both debt service and increased import requirements.

In my prepared statement I drew up a little model showing what would happen if exports increased at 2 percent a year and imports increased at 3 percent a year, and assuming that initially imports were $1 billion and exports were $900 million leaving an initial gap of $100 million.

In this model, the initial gap of $100 million to be filled with capital imports during the first year rose to $500 million in the 10th year, and to $1.25 billion after 20 years; in other words over 12 times the initial gap.

The purpose of this exercise is simply to indicate that aid in the form of loans is not by itself a feasible substitute for trade. Loans can provide an important boost for less developed countries. But within a reasonable period of time their exports must rise at a rate exceeding the rate of growth in import requirements, if service on loans is to be maintained.

Of course, if aid is provided in the form of grants, you do not have the servicing problem. But even here, if countries are to achieve a condition of self-generating growth, they must find ways of increasing their exports.

While our loans and investments to the less developed countries have been large and rising in recent years, so also have our earnings on foreign investments. As a matter of fact, currently, earnings on private investments and Government loans are running about $3 billion a year, and there is another billion or so that is reinvested abroad and not transferred to this country.

countries will continue to exceed earnings received from investments abroad for the next 20 or even 10 years. As a matter of fact, during the 1949 to 1955 period, in each year earnings on foreign investments

I think it is rather unlikely that net capital flow to the less developed exceeded net capital outflow, both Government and private, and it has only been in the last 3 years that net capital outflow has exceeded our earnings.

Most projections, I think, indicate that net capital exports to the less developed areas will be lower than our earnings on existing investments. This means that if we continue to make foreign loans and investments at current rates over the next decade or so, we may need to adjust our economy to a rather substantial import surplus as the volume of our gross capital outflow begins to level off. When I say we, perhaps I should also include Western Europe as well as the United States.

Let me now state briefly what I believe are the implications of this analysis for the U.S. economy.

Assuming it is the policy of the United States to promote economic growth in the less developed areas with the aid of private foreign investments and public loan capital, the United States and Western Europe—and I stress Western Europe in this connection—must adjust their foreign commercial policies so as to permit a steadily rising flow of imports from these countries, including both manufacturers and primary products, and avoid policies which restrict markets for commodities like cotton, wheat, and rice, in which we are competitive with nonindustrialized countries. This will not involve a large adjustment for the United States. A doubling of our nonpetroleum imports from the less developed areas would amount to only about 1 percent of our gross national product. If we were to do this over a period of 10 years, the adjustment problem would be negligible.

Moreover, I think adjustments of this kind, that is, permitting increased imports and avoiding subsidized exports, would increase the real income of the United States, would help to stabilize prices and, above all, benefit that forgotten man known as the consumer.

If, on the other hand, we insist on maintaining agricultural and mineral policies which restrict the normal growth of exports of the less industrialized countries, the only way we can provide the capital and the growing volume of commodities which they need for growth will be through grants. In other words, if aid is to be provided in the form of loans, aid is not a substitute for trade.

I think it is important that those who have been arguing for the elimination of grants in favor of more loan capital to the less developed countries realize fully the implications of their position for U.S. foreign trade policy. I am very much in favor of loans and private investment for development, but only if we have a foreign trade policy which permits these loans and investments to be serviced.

Thank you.

Representative BOLLING. Thank you, sir.

Your statement will be printed in the record at this point.

(The statement referred to follows:)

STATEMENT OF RAYMOND F. MIKESELL, W. E. MINER, PROFESSOR OF ECONOMICS, UNIVERSITY OF OREGON, ON THE UNDERDEVELOPED AREAS AND THE U.S. ECONOMY

Unless we should be deprived of access to imports from the less developed areas, economic changes in the less developed areas over the next decade or two are not likely to be of major significance for employment, growth, and price levels in the United States. There is little evidence that tight conditions of supply for basic commodity imports will occur forcing up prices of imported primary commodities. There may well be international action to mitigate sharp fluctuations in prices of commodities such as coffee, but this should contribute to U.S. price stability.

The underdeveloped areas account for nearly 50 percent of U.S. foreign trade; and in 1958 our exports to them represented about 1½ percent of our gross national product. We may expect a gradual but by no means spectacular growth in this trade. In fact, there is good reason to expect that our exports to these countries will not continue to grow at the high rates existing prior to 1958. The pattern of this trade, particularly on the U.S. export side, will change as these countries industrialize, and this will affect markets important to particular U.S. industries. For example, 20-year projections recently published by the Economic Commission for Latin America indicate the virtual elimination of imports of agricultural products and textiles from outside Latin America, but they expect a substantial increase in their imports of machinery and automobiles. On the other hand, U.S. exports of agricultural commodities may continue to expand to food and fiber deficit areas. A recent study by a panel of experts sponsored by GATT suggested that "it may be a natural and economic development that relatively poor countries with high population densities like India and Hong Kong should export cheap labor intensive manufactures in order to import foodstuffs like wheat from developed countries such as Australia, Canada, and the United States, which are rich in capital and land." [1] Hence, if we want to remain large exporters of agricultural commodities, we may need to open our doors to imports of manufactures from some of the less developed countries. In fact, successful industrialization in many countries that must industrialize in order to find employment for their growing population will require the development of substantial export markets for their manufactured products.

## GROWTH RATES IN UNDERDEVELOPED COUNTRIES

The rate and pattern of growth in the less developed areas of the world is perhaps more important for its political and strategic significance than for its economic significance for the U.S. economy as a whole. What that growth pattern will be depends in considerable measure on the trade, investment, and foreign assistance policies of the United States and our Western European allies, and these policies in turn have important economic implications for our economy. Hence, in dealing with the problem of the significance of economic changes in the less developed countries for the U.S. economy it is perhaps more fruitful to examine the economic consequences of alternative policies toward these areas.

Over the period 1950–57, the less developed countries as a whole experienced growth rates ranging from around 4.5 percent a year in the case of Latin America, to somewhat lower rates in southeast Asia and the Middle East. Substantial differences in growth rates have occurred among individual countries. For example, the rate of growth in Argentina since 1948 has been less than 2 percent, as against 8 percent for Venezuela. In southeast Asia, Pakistan's rate of growth has been only a little over 2 percent as against 6 to 7 percent for Thailand, and about 3.4 percent under India's first 5-year plan. To a considerable degree, differences in growth rates can be attributed to developments in the export sector of the economy. For some countries the rise in export earnings in the postwar period has resulted from an increase in the volume of exports, while for others, export volume has increased very little but export prices have risen considerably more than the prices of the commodities they import.

Over the past couple of years there has been a noticeable decline in the rate of growth in the less developed countries. A number of these countries have also been experiencing serious balance-of-payments difficulties. This has occurred in spite of a larger flow of capital to the less developed regions. While the fall of primary commodity prices and export earnings beginning in the second half of 1957 was an important factor in reducing the rate of economic progress, a number of countries were running into difficulty maintaining growth momentum even before the 1957–58 recession. This has been due in part to the fact that the terms of trade have been moving against most countries producing primary products for several years, whereas before 1954 their terms of trade tended to improve. Fundamentally, the difficulties experienced by most underdeveloped countries lie in the fact that their export earnings have been lagging behind the import requirements associated with a steady rate of economic growth.

Perhaps the most important single factor in determining both the rate of growth of the less developed areas and the impact of their development on the U.S. economy lies in the future pattern of their exports to the industrial countries.

[1] "Trends in International Trade," GATT, Geneva, October 1958, p. 80.

Experience has shown that economic progress depends heavily upon the ability to expand imports of fuel, raw materials, capital goods, and, in some cases, foodstuffs and consumers goods as well. While capital imports are important for accelerating development, they can provide only a temporary means of maintaining imports in the face of constant or slowly growing exports.

TRENDS IN EXPORTS OF NONINDUSTRIALIZED COUNTRIES

What then is the outlook for the exports of the less developed countries to the industrial countries of the United States and Western Europe? Before considering current projections of imports from the nonindustrial countries for the future, I want to look briefly at what has happened in the past. The findings of a recent GATT study on this subject are revealing. Over the 20-year period 1937–38 to 1957, the nonindustrialized countries combined increased the volume of their imports by 104 percent and the volume of their exports by only 40 percent, of which increase more than half was accounted for by petroleum exports. Fortunately the terms of trade of primary commodity exports rose significantly in the early postwar period so that the real value of the export proceeds of the nonindustrialized countries rose substantially over prewar levels. However, between 1954 and 1958 the terms of trade between primary products and manufactures moved against primary products to the extent of about 15 percent and by an even larger percentage if minerals and petroleum are excluded.

As compared with prewar (1937–38) the volume of exports of countries exporting mainly nontropical foodstuffs—including Argentina, Burma, Cuba, New Zealand, and certain African countries—had declined by 10 percent by 1955. Over this same period, the volume of exports of countries exporting mainly agricultural raw materials—including Australia, Egypt, Finland, India, Pakistan, Indonesia, Indochina, Malaya, Mexico, Philippines, Syria, and Lebanon—rose by only 6 percent. The volume of exports of countries exporting mainly tropical foodstuffs—including Brazil, Ceylon, Costa Rica, Dominican Republic, and several African countries—rose by 13 percent or about three-fourths of 1 percent per year over the 17-year period. Those countries exporting mainly minerals—including the Belgian Congo, Chile, the Federation of Rhodesia, Peru, and the Union of South Africa—raised their export volume by 41 percent, or by 2.3 percent per year. The handful of countries exporting mainly petroleum products raised their export volume by nearly fourfold.[2] But the vast majority of nonindustrial countries increased their export volume over the 17-year period by less than 1 percent per year while their import volume was expanding at a rate of over 4.5 percent per year. Moreover, for a number of nonindustrial countries, export volume has declined or has not increased appreciably either since 1937–38 or since 1928.

The substantial rise in the volume of imports into the nonindustrial countries has been made possible in large measure by the nearly 25 percent improvement in the terms of trade between prewar and 1955, and by capital imports. For countries like India and Egypt, which accumulated large sterling balances during World War II, imports have been financed by the drawing down of these balances. The outlook for any significant longrun improvement in the terms of trade is doubtful, especially for those countries that are mainly exporters of agricultural commodities. In other words, the nonindustrialized countries cannot count on another terms of trade windfall in the foreseeable future. In fact they will be lucky not to lose more of what they have gained during the earlier postwar period.

Considering U.S. imports from the less developed areas, there has been no increase even in the dollar value of U.S. imports since 1951. In fact if we exclude petroleum imports, U.S. imports from nonindustrial countries were substantially lower in both 1957 and 1958 than they were in 1951 and 1952. On the other hand, U.S. exports to less developed areas were less than $6.2 billion in 1951; but were $7.9 billion and $7.0 billion in 1957 and 1958 respectively.

Now let us turn to the projections of exports of primary products to Western Europe and North America (United States and Canada) from the rest of the world. These projections have been made on a number of different bases, but when they are reduced to the same conceptual basis, i.e., net imports of primary products into Western Europe and into the United States and Canada (taken as a unit), estimates of the increase in net imports between 1953–55 and 1973–75

[2] Ibid., p. 23.

range from a low of 12 percent to a high of 60 percent.[3] While the margin between these figures is very wide, the interesting thing to note is that the difference between the most pessimistic and the most optimistic estimates can be accounted for largely by differences in the estimates for net imports of nontropical foodstuffs into North America and Western Europe and in the estimates of cotton exports by the United States to the rest of the world. Relatively small changes in the production of agricultural commodities in the United States, Canada and Western Europe will affect rather substantially the rate of export growth in the nonindustrial countries. Thus if the United States increases substantially its exports of grain and cotton, and if Western Europe seeks to become more self-sufficient in foodstuffs, total exports of these commodities by the nonindustrialized countries will decline, thereby offsetting some of the increases in their exports of other foods and of fuel and raw materials. U.S. import policies with respect to petroleum and certain metals will also play a significant role in the growth of exports of the less developed areas.

Considering the fact that the less developed countries increased their imports (in constant prices) by over 50 percent between 1950 and 1957 (60 percent for Latin America) and taking into account the past relationships between imports and output growth, it is most unlikely that the less developed countries can maintain satisfactory rates of growth in output unless their imports grow at a rate of 2 to 2½ percent per year over the next couple of decades. This means that over the next 20 years, their exports to the industrialized countries must increase by some 50 to 60 percent over current levels. According to current projections, this will not be difficult for countries exporting mainly fuels and minerals. But for countries exporting chiefly agricultural commodities there may be great difficulties, largely depending upon the agricultural policies of industrialized countries of North America and Western Europe.

## RULE OF CAPITAL EXPORTS

But if the less developed countries cannot export enough to buy the imports they need for growth, why can't we fill the gap with capital exports? External capital, both private and public, has been quite important in financing the imports of the less developed areas in recent years. For example, in 1957 gross capital inflow for Latin America alone amounted to over $2.2 billion (excluding grants) and net capital inflow is estimated at over $1.6 billion. About half of the gross capital inflow into Latin America in 1957 was private direct investment and the remainder took the form of loans or credits from both private and governmental sources. But loan capital and private investment cannot continue indefinitely to fill the gap between rapidly rising imports and stagnating or slowing rising exports. Capacity to service increased loans and foreign investment depends upon increased foreign exchange income. A simple example will illustrate this point. Suppose that a country borrows $100 million per year at 5 percent interest with the loans amortized over a period of 20 years. At the end of 12 years the service charges on the capital already received will equal the annual new capital inflow, and after 20 years, debt service will amount to about $150 million per year as against gross capital inflow of $100 million per year. Obviously at the end of 12 years export earnings must have risen by at least $100 million unless, of course, import requirements have fallen by that amount. However, it is more likely that import requirements will have risen substantially in the meantime, so that foreign exchange earnings must have increased sufficiently to provide for both the debt service and the increased import requirements.

But why can't capital imports continue to rise to fill the gap resulting from exports growing at a slower rate than imports? They can, but the volume of capital required soon grows to gigantic proportions. Let us assume that a country imports a billion dollars annually and exports $900 million, leaving a gap of $100 million to be filled by capital imports; and that its import requirements are growing at 3 percent per year while its exports increase at the rate of 2 percent per year. In the first year capital imports of $100 million will fill the gap. How-

[3] These are GATT estimates. See "International Trade, 1956," GATT, Geneva, 1957, p. 35. Optimistic ECE estimate is 75 percent increase from 1954–56 to 1975. See "Economic Survey of Europe in 1957," Geneva, 1958, ch. V, p. 4. ECE estimates are not net import estimates as is the case with GATT estimates. Under certain assumptions regarding U.S. trade in agricultural products, the rise in net imports will be lower than the rise in gross imports. For a comparison of projections see "Trends in International Trade," op. cit., pp. 52–54.

ever, at the end of 10 years gross capital imports of $480 million will be required to fill the gap, again assuming 5 percent interest on loans amortized over 20 years. At the end of 20 years, it will require gross capital imports of a billion and a quarter dollars to fill the gap. In other words, at the end of 20 years it will take over 12 times the amount of gross capital inflow to fill the gap as it took for the first year. Moreover debt service payments will be equal to nearly 60 percent of the country's export earnings. It is scarcely conceivable that our international lending institutions would continue to make loans to countries under these conditions, especially when a debt service-exchange earnings ratio of 10 to 15 percent is regarded as a normal maximum.

The purpose of this exercise is to indicate that aid in the form of loans is not a feasible substitute for trade. Loans can provide an important boost for less developed economies, but within a reasonable period of time their exports must rise at a rate exceeding the rate of increase in their import needs if services on the loans is to be maintained. Of course, if aid were to be made available in the form of grants, the problem would take on a somewhat different aspect since the recipients would not have to meet the growing burden of service charges on past loans.

I should also point out that this problem cannot be solved by substituting direct private investment for loans or trade, since private capital must also be serviced, frequently at a higher rate than loan capital. In fact private capital is not going to go into countries unless the balance of payments prospects are favorable or unless private enterprise intends to product for an export market and is permitted to retain its export proceeds for remittances abroad.

While our loans and investments in the less-developed areas have been large and rising in recent years, so also have our earnings from these investments. It is rather unlikely that the net capital flow to these countries will continue to exceed the earnings received from these investments for the next 20 years. In fact, most projections I have seen indicate that net capital exports to the less-developed areas will be lower than our earnings on existing investments. This would mean that if we continue to make foreign loans and investments at current rates over the next decade or so, we may need to adjust our economy to a rather substantial import surplus as the volume of our gross capital outflow begins to level off.

## IMPLICATIONS FOR U.S. FOREIGN TRADE POLICY

Now I would like to state briefly what I believe are the implications of this analysis for the U.S. economy. Assuming it is the policy of the United States to promote economic growth in the less-developed areas with the aid of private foreign investment and public loan capital, the United States and Western Europe must adjust their foreign commercial policies so as to permit a steadily rising flow of imports from the less-developed countries and avoid policies which restrict world markets for commodities like cotton and wheat in which we are competitive with nonindustrialized countries. This will not involve a large adjustment for the United States. A doubling of our nonpetroleum imports from the less-developed areas would amount to only about 1 percent of our gross national product and if we were to do this over a period of 10 years, the adustment problem would be negligible. Moreover, adjustments of this kind, i.e., permitting increased imports and avoiding subsidized exports, would increase real income in the United States, would help to stabilize prices, and above all, benefit that forgotten man known as the consumer.

If on the other hand we insist on maintaining agricultural and mineral policies which restrict the normal growth of exports of the less-industrialized countries, the only way that we can provide the capital and the growing volume of commodities needed by the less-developed countries for satisfactory rates of growth will be through grants. In other words, if aid is to be provided in the form of loans, aid is not a substitute for trade. I think it is important that those who have been arguing for the elimination of grants in favor of more loan capital to the less-developed countries realize fully the implications of their position for U.S. foreign trade policy.

Representative BOLLING. Next is Simon Rottenberg.

## STATEMENT OF SIMON ROTTENBERG, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Mr. ROTTENBERG. When we speak of the underdeveloped countries of the world, we usually mean the relatively poor countries, and the word "underdevelopment" is really a euphemism for poverty.

The poor countries are spread over the earth and are of many different cultures and at many different average levels of poverty. They are different in many respects but there are, nonetheless, sufficient qualities common to many of them to make it worthwhile, for some purposes, to treat them as though they were of the same class.

I shall discuss those changes and policies in the poor countries that can have effects upon the American economy. I shall draw illustrations from the experience of the Latin American countries, but much of what characterizes them is also valid for other hemispheres and continents.

Among the Latin American countries there is a great deal of variation in the average degree of poverty. It is a hazardous business to make international comparative estimates of income, but one such attempt found that the value of goods and services produced per head of population ranged from a top of $588 per year for Venezuela (1954) to a bottom of $58 for Bolivia (1955). The corresponding (1956) figure for the United States was $2,045.

The much lower level of life in Latin America than in the United States can also be seen from selected comparative physical data in the chart below. Some of these are shown for Argentina, one of the richest countries of the hemisphere, and Bolivia, one of the poorest.

(The table referred to follows:)

| | Income per capita | | Percent illiterate (10 and above) | Newsprint consumption (kilos per capita) | Infant mortality per 1,000 live births | Road miles per 1,000 square miles |
|---|---|---|---|---|---|---|
| | Amount | Year | | | | |
| United States | $2,045 | 1956 | 3 | 34.2 | 26.5 | 1,123 |
| Argentine | 457 | 1955 | 14 | 6.5 | 65.2 | 82 |
| Bolivia | 58 | 1955 | 80 | .9 | 116.7 | 22 |

Mr. ROTTENBERG. It is clear that the poor countries have a long way to go to catch up in the income race. Indeed, the evidence seems to be that, at least absolutely, they are falling behind. That is to say, the difference between per capital output of goods and services in the United States and in the poor countries seems now to be absolutely greater in magnitude than it was formerly. At least this seems to be true for the few years for which income estimates are available for Latin America. The earliest serious income estimates for these countries are a few made for some countries for some years during the 1940's.

Nevertheless, it is likely that income has been growing in the secular long run in the poor countries and that, on the average, people are substantially better off now than they were, say a half century ago.

This secular growth in income is the first change I should like to refer to as having effects for the American economy. There is, in Latin America, a high propensity to import. People have a certain preference for imported over domestically produced goods and this applies to both capital goods and consumer goods. I shall not examine the reasons for this except to mention that it is caused partly by standards of fashionable taste and partly by a certain distrust of the standards of quality of locally produced goods.

Whatever the causes, a given increase in income will provoke a larger proportional increase in imports than it would in the United States. The secularly rising real income trends in the poor countries, therefore, can be expected to expand the volume of international trading in which these countries are engaged.

Latin America is, of course, a rather important export market for the United States, in 1958 one-quarter of all American exports, by value, excluding military shipments, were destined for the Latin American countries. For some industries it was more important still. For example, 43 percent of all U.S. exports of transportation equipment went to Latin America.

The stimulus to international trade produced by rising incomes would be even greater, if it were not for a constellation of policies applied in Latin America which have opposite effects.

One of these is the policy of overvaluing national currency in terms of foreign currency. At first sight, it would appear that this would stimulate imports into Latin America by cheapening imported goods in terms of local currency. And, indeed, the objective of this policy is precisely to cheapen imported goods because some of them are important to the consumption expenditures of the working classes and it is sought to prevent the cost of living for them from rising.

It can be observed, on the other hand, that overvaluation of local currency also has the effect of making exports unattractive by causing the prices of goods produced in Latin America to be high for foreign buyers. Since, in the long run, the aggregate value of exports determines the aggregate value of imports, the policy of currency overvaluation diminishes the supply of foreign exchange available to the Latin American countries and, therefore, diminishes the quantity of its imports.

Another policy that tends to diminish imports is that of induced industrialization. The idea that the conquest of poverty requires a change in the composition of the output of the economy has great power among the intellectual and policymaking classes of Latin America. A very elaborate rationale has been contrived in its defense.

To some extent it is emotive. Producers of primary and agricultural products who exchange them for manufactured goods are supposed to be hewers of wood and drawers of water who stand in a servant's relationship to masters. To some other extent, the defense is intellectual. The terms of trade are said to have moved historically against primary products so that more of them must be given up in exchange for a unit of manufactured goods than formerly.

There is said to be a high positive correlation in the world's experience between the proportion of output that derives from the manufacturing sector and average levels of income, so that the one rises with the other. The rural areas are said to be producing an abundance of people for whom employment outlets must be found elsewhere and only two hypothetical alternatives are said to exist: Low-productivity urban service employment and high-productivity employment in manufacturing. The prices of primary products are said to fluctuate too widely and too high a proportion of the total output of the economy is said to be produced by primary products.

And, finally, foreign exchange is said to be a scarce and strategic resource which ought to be used to promote growth by being spent for capital goods; therefore, manufactured consumer goods ought to be domestically produced to save foreign exchange for other uses.

I do not discuss the merit of this case. It suffices that it is widely believed to be true in Latin America and has spawned a number of policies that have generated above-average growth of the manufacturing sector and moved resources out of other sectors and into manufacturing.

The outcome is diminished international trading. Some have denied this and have suggested that the relative growth of manufacturing will leave the total volume of international trade unaffected but will merely change the composition of imports such that the capital and intermediate goods used by the manufacturing sector will become more important.

But it can be seen that the case for industrialization remains unchanged at every stage of the industrialization process. Before manufactured consumer goods—shoes, textiles, and so forth—are produced domestically, it is a case for producing them in the country. When they are produced domestically, it is a case for producing capital and intermediate goods domestically. And so on.

The movement of resources to the manufacturing sector is done by subsidizing that sector and taxing other sectors—either directly or indirectly. There have been, for example, cases of differential exchange rates for imports and exports that advantage importers of industrial capital and intermediate goods and disadvantage exporters of the products of agriculture and mines. There have been public investments in social overheads that especially favor industrial users and public investments directly in industrial plants. There have been public capital appropriations to cover the losses of publicly sponsored industrial enterprises. There have been export quota controls for industrial primary products that have lowered the prices of these products to domestic manufactures. There has been especially heavy import duty protection for industrial producers. And the manufacturing sector has been given especially advantageous access to credit.

Three effects of these policies suggest themselves. One has already been mentioned. That is that, in the long run, the volume of international trade will be less than it would have been, if the Latin American countries continued as international specialists in the production of the things for which they have a relative comparative advantage over other countries, rather than becoming diversified producers.

A second is that the composition of their imports will change such that they will import proportionally more capital goods and proportionally less consumer goods.

A third is that, to the extent that the primary-producing sectors, the prices of primary products will be higher than they otherwise would be.

Latin America is, of course, an important supplier of primary product to the United States, as the following table shows:

| | Percent of total U.S. imports originating in Latin America | | Percent of total U.S. imports originating in Latin America |
|---|---|---|---|
| Bananas | 100 | Copper | 55 |
| Coffee | 87 | Zinc | 52 |
| Cane sugar | 79 | Lead | 49 |
| Cocoa | 52 | Manganese ore | 48 |
| Crude petroleum | 57 | Sisal and henequen | 76 |
| Residual fuel oils | 50 | Cotton, unmanufactured | 45 |
| Nickel oxide | 80 | Wool, unmanufactured | 25 |
| Iron ore | 62 | Tobacco and products | 27 |
| Tungsten ore | 58 | | |

Not very much is known about the distribution of income among families in Latin America. The few studies that have been made have had to make do with untrustworthy data.

It appears to be true, however, that income is more unequally distributed there than in North America. That is to say, the top, say, 5 percent of income-earning families receive a larger share of the whole income of the community in Latin America than in North America. On the other hand, the number of classes has tended to become larger over time and a new and numerous middle class has grown up rapidly in recent decades. This can be taken as evidence of a long-run tendency toward more equal income distribution and I think we can expect, with some confidence, that this tendency will continue into the future.

The composition of family expenditures of the middle income-earning families is, of course, different from those of the low income-earning families. A very large part of the expenditures of the latter is for foodstuffs, while the consumption of somewhat higher income families is more diversified.

The more equal spread of income, therefore, can be expected to have some effect upon the composition of imports and I think this cause, independently of other causes that have other, and perhaps opposite, effects, should provoke an increase in the proportion of manufactured consumer goods in the total of all imports.

The progressive urbanization of the hemisphere can be expected to have like effects, since the things urban families buy in the market are different from those bought by rural families. The domiciliary distribution of the population of Latin America has, of course, changed profoundly. Almost everywhere in the hemisphere, urban population has increased more rapidly than rural and in most countries for which the data are available the greater part of the increase in urban population is attributable to migration from the rural areas.

Still another factor that will affect the composition of Latin American imports is the change in the age composition of the population. The recent progress in medicine and sanitation has reduced the death rate sharply of people at all age levels but it has reduced death rates for infants more than for adults. As a result, the population is becoming progressively younger. In most countries of Latin America more than 40 percent of the total population is less than 15 years old and this can be compared with corresponding percentages of 37 for the United States and between 20 and 30 for the countries of Western Europe.

The Latin American and U.S. economies are related to one another not only by the international exchange of goods but also by the international exchange of capital and services.

American investments in Latin America date from before the middle of the 19th century. In 1957 of a total of $25.3 billion of American foreign investment, $8.3 billion was in Latin America.

This was distributed among sectors as follows:

| | Percent | | Percent |
|---|---|---|---|
| Mining and smelting | 14 | Public utilities | 15 |
| Petroleum | 36 | Trade | 6 |
| Manufacturing | 19 | Others | 10 |

The $8.3 billion of American direct investment in Latin America is not a net figure and it has not been adjusted downward for rather large portfolio holdings of American equities by Latin Americans.

The value of American investment in other countries of the hemisphere has been increasing. It was $3 billion in 1946. This exchange of capital has nourished both economies. It has produced earnings for American investors and has helped to set aright the relative scarcity of capital in Latin America. It has also implicitly introduced into Latin America technical and managerial skills, the findings of industrial research efforts, and standards of entrepreneurship that accompany capital, especially when it is directly invested rather than being held in portfolios. All of these, too, are in scarce supply in Latin America.

There are a number of factors, however, which have tended to diminish the quantity of foreign, including American, investment in Latin America.

The practice of overvaluing local currency that has previously been referred to has created chronic shortages of foreign exchange—that is, chronic balance-of-payments crises—and induced foreign exchange rationing. The rationing rules have sometimes made it difficult for foreign firms to convert their earnings to dollars or other foreign currencies to remit them home.

The balance-of-payments crises have also caused time-to-time changes in the rationing rules which have affected the price of foreign exchange. Firms specializing in production operations have, therefore, found it necessary, in order to protect themselves, also to become foreign exchange traders and to engage in arbitrage transactions overtime.

In some countries there are sectors in which foreign investment is unacceptable. These are usually the mining sector and here it is said that foreign investors despoil the country of its riches, leaving holes in the ground.

In some there is a political atmosphere that regards foreign firms as exploiters of the country's labor.

In some there are formal or informal requirements for substantial, and sometimes majority, equity participation of nationals of the country.

In the case of public utilities, rate controls depress yields on capital below those in alternative uses.

And, in some countries, foreign properties have been expropriated, sometimes with and sometimes without adequate compensation.

This constellation of occurrences has undoubtedly caused many American firms that would have invested in Latin America under more favorable circumstances to hesitate and has lessened the quantity of American capital exports to those countries.

Impediments of much the same nature inhibit the international exchange of services and depress the number of American service-selling firms establishing branches or subsidiaries in Latin America. In some countries, for example, local firms have the monopoly, vis-a-vis foreign firms, of internal air transport service; in some, foreign banks or insurance companies are not permitted to function.

There are obstacles also to the international exchange of persons and these, sometimes, apply with especial force against persons with professional and technical skills and knowledge, despite the fact that people of these implicit occupational classes are relatively most scarce.

Thus there are rules that impose severe constraints upon foreign firms with respect to the number of foreigners they may have in their employ; rules that permit only nationals of the country to practice accountancy, engineering, medicine, or the law; or rules that require a degree from some local university as a condition to practice some professions. These rules that monopolize the local market for nationals prevent an easy and direct access to the Latin American market for American technical and professional personnel.

The practices discussed in this statement have grown up gradually and the weight of the informal evidence seems to indicate that they will continue and perhaps become more sharply applied. The sum of their effects will probably be depressive upon the international exchange of goods, services, capital, and skilled people of the Latin American countries with the United States.

The CHAIRMAN. Congressman Bolling, will you start the questions?

Representative BOLLING. First, I would like to see if we have any disagreement among the panelists with the statements that they have made, or if it seems more appropriate to ask, is there is general agreement one with the other?

Mr. ROTTENBERG. I have an impression we have rather reached a consensus.

Representative BOLLING. I thought you had, but I wanted to be sure, for the record.

There were a number of things said in the various statements that lead me to believe that all of you agreed that there were at least one or two areas in which U.S. policy relatively simply, although perhaps not politically easy, could make a great difference in the growth of the underdeveloped areas. I gathered, and I think particularly Mr. Mikesell emphasized this, that our policies, basically domestic in the field of agriculture and minerals, created an overhang on world markets which, combined with perhaps somewhat restrictive policies on imports in Western Europe, had a profound short-range longrun effect on the capacity of the underdeveloped countries to export. Is that assumption correct?

Mr. MIKESELL. Yes, Congressman Bulling. I cited some projections by the GATT Secretariat which were developed a couple of years ago and reemphasized by a panel of experts, chaired by Professor Huberler of Harvard in a GATT report entitled "Trends in International Trade," published last year. The theme of this report was the concern over just where, over the next 20 years, the nonindustrialized countries are going to find the markets for the exports that they must have if they are going to meet their import requirements and also service the large amount of capital investment that is going into them.

The picture on the basis of what has happened in the past is not very favorable. Except for certain minerals and petroleum, the growth of export volume has been very slow. Many of these countries produce largely tropical foods and beverages. There is a sort of vegetative growth in these commodities. Others, however, produce commodities like cotton, fats and oils, and wheat, which are in competition with producers in the industrialized countries. According to current projection, whether these countries as a group are going to be able to expand their exports in line with their import requirements over the next couple of decades depends in large measure upon the agricultural policies of Western Europe and the United States.

Mr. Carlson has mentioned that certain parts of the world will need our foods and that there are food-deficit areas in the nonindustrialized countries that perhaps would want to import from the United States. I would like to raise two questions on this point.

In the first place, could they not import food from some of the food-surplus areas of the nonindustrialized countries? Will they be able to do so? And secondly, if we do continue to expand our exports of food and fibers to these countries, what are the United States and Western Europe, directly or indirectly, going to buy from them? Are we going to buy industrial commodities from India?

As a matter of fact, many of these countries will be needing foreign markets for their industrial products. I feel very strongly that many of these countries cannot go much further in industrializing without developing external markets for their industrial products.

Representative BOLLING. I want to be sure I am keeping up with this step by step. At their present stage—and this is in gross terms—they primarily are exporters of raw materials?

Mr. MIKESELL. That is right.

Representative BOLLING. As they move along they increasingly become self-sufficient in certain manufactures and need export markets for the things that they manufacture.

What are some of the things, aside from textiles, that some of these countries are likely to need markets for in the manufacturing field, in generalized terms?

Mr. MIKESELL. I do not know enough about the export potential of some of these countries to say very much about them. They are exporting shoes and bicycles, goods of this type.

Representative BOLLING. Underdeveloped countries?

Mr. MIKESELL. Yes.

Representative BOLLING. Bicycles?

Mr. MIKESELL. Yes.

Representative BOLLING. I did not realize that.

Mr. MIKESELL. I think perhaps Mr. Carlson is more familiar with some of the industrialization than I am.

Representative BOLLING. But this would be what? The kind of manufacture in which the value added is relatively low?

Mr. MIKESELL. Probably in some cases they might want to export labor-intensive commodities, and perhaps commodities that are less research intensive, if we can make this distinction.

Representative BOLLING. In other words, they will be wanting to export the things that are, in oversimplified terms, simpler kinds of manufacture rather than, on the other scale, highly complicated technical machinery, and so on, so that they will be inevitably in the relatively simple type of manufacturing, or the labor-intensive type?

Mr. MIKESELL. That is right.

Representative BOLLING. We have not gotten to the point that I am particularly interested in, that is, how important would it be if we were able from the point of view of the growth of the underdeveloped areas, if we were able to neutralize completely our agricultural surpluses? Can this be quantified in any way? Would this be 10 percent of the problem, 20 percent of the problem, a large share of the problem, a small share?

Mr. MIKESELL. It can be quantified in accordance with the projections made by the GATT, and some other projections. There are several sets of projections. I do not have them before me, but as I recall, in terms of their assumptions, the projections of increases in the nonindustrialized countries' exports over the next 20 years, which range from about 12 percent to over 60 percent, over half of the difference is explained by differences in assumptions regarding the agricultural policies of the United States and Western Europe.

Representative BOLLING. Let's separate those two at that point.

Western Europe as a whole is what in relation to agricultural products?

Mr. MIKESELL. They are net importers. If we project Europe's requirements of foods and fibers and some agricultural products, and then make different assumptions as to what their agricultural policies will be, we obtain different estimates of what their agricultural imports will be.

Representative BOLLING. Can you relate that in any quantified terms to the overhang of American agricultural surpluses? You see what I am getting at?

Mr. MIKESELL. Yes; I see what you are getting at. You would like to know the quantitative aspect of it, the importance of U.S. policies in this picture. I simply cannot give it to you at the present time. I could perhaps work it out from the GATT projections.

Representative BOLLING. I think that would be very interesting, because it would make it possible for those of us who feel very strongly on this particular subject to have a little greater impact.

Mr. MIKESELL. I will be glad to do my best to supply them. I might have to write to the GATT Secretariat for some more information.

Representative BOLLING. I think it would be well worth having, because it is obvious that in general terms, this overhang is of incredible importance in the very sense that you have all put it. But as far as the politician is concerned, it is important to be able to state it in such a way that the urgency of the matter and its relationship become clear, not only to the people who think generally as we seem to, but to those who do not see the problem in more than very narrow terms. I would think that this would be the first step, perhaps a little bit better than we have, in facing this problem realistically.

So I think this information would be helpful.

(The information referred to follows:)

The accompanying table prepared by the GATT Secretariat gives estimates of net imports of primary products by Western Europe and North America (United States and Canada combined) for 1973–75 as compared with 1953–55. The estimates of net imports range from $14.5 billion to $20.9 billion for 1973–75, a difference of $6.4 billion between the optimistic and the pessimistic estimates. It will be observed that $3 billion of this difference is accounted for by the difference in the estimates of net exports of foods by the United States and Canada combined and these estimates in turn are based largely on different assumptions regarding U.S. agricultural production and export policies. In addition the range of estimates for the United States and Canadian (combined) net raw material and fuel imports ($0.6 billion to $1.4 billion) depends in considerable measure upon differences in assumptions regarding U.S. cotton policies.

*Net imports of primary products in Western Europe and North America, 1953–55 and prospective 1973–75* [1]

[Thousand million dollars f.o.b. at 1953-55 prices]

| | Western Europe | | North America | | Total | |
|---|---|---|---|---|---|---|
| | 1953–55 | 1973–75 | 1953–55 | 1973–75 | 1953–55 | 1973–75 |
| Coffee, tea, and cocoa | 1.4 | 2.0 | 1.8 | 2.6 | 3.2 | 4.6 |
| Fruits and vegetables | .7 | 1.2 | .1 | .2 | .8 | 1.4 |
| Other food | 2.9 | 2.2 4.8 | −1.3 | −4.9 −1.9 | 1.6 | −2.7 +2.9 |
| Total food | 5.0 | 5.4 8.0 | .6 | −2.1 +.9 | 5.6 | 3.3 8.9 |
| Total raw materials and fuels | 6.2 | (10.6) | 1.15 | (.6) (1.4) | 7.35 | 11.2 12.0 |
| Primary products as a whole | 11.2 | 16.0 18.6 | 1.75 | −1.5 +2.3 | 12.95 | 14.5 20.9 |

[1] Source: "International Trade 1956, the Contracting Parties to the General Agreement on Tariffs and Trade, Geneva, June 1957." p. 35.

Mr. ROTTENBERG. May I interject with reference to the overhang of the surplus? It seems to me it needs to be realized that this affects the poor countries differentially. Some of them are not affected by it at all. The banana, cocoa, and coffee countries for example, are among those which are not affected by them. But some of them are affected very greatly.

Representative BOLLING. The next point I would like to get at is in connection with this very point, the differential nature of the effect. Is it possible to demonstrate any relationship between the urge for industrialization and the type of production, agricultural and mineral, produced in the country, as it is or is not desired and imported by the well-to-do countries like Western Europe and the United States? In other words, is the country that produced the tropical food less interested, because it is in a relatively good situation economically? Is it less interested in moving into industrialization than a country which produces the food or fiber competing with an overhang? Is there any indication of this being the case?

Mr. ROTTENBERG. I think in this case all we can do is sort of render impressions. The desire to industrialize is something that sweeps widely all over the world. People believe that this is the only way in which economies can grow.

Representative BOLLING. This, you think is likely to be true regardless of whether the economy is relatively prosperous or in a relatively favorable position within the underdeveloped group?

Mr. ROTTENBERG. I think that is so.

The notion that this is the way you conquer poverty has its origin in a period that precedes the adoption of policies by the United States, by which the surplus overhangs were created. It is older than that.

Representative BOLLING. Now, to go back to the manufacturer. Assume for the moment that we solve the overhang problem in this country. Assume that Western Europe has a more or less a middle position with regard to self-sufficiency and decides not to be as self-sufficient as they possibly can be, although possibly a bit more self-sufficient than they now are; and assume this drive for increased manufacturing. I take it that this situation is in effect not quite upon us yet but is almost upon us, namely that there will be more and more competition, as far as the U.S. manufacturers are concerned, from underdeveloped areas in the next 10-year period. Is that a safe assumption?

Mr. CARLSON. Let me make one comment on that.

It seems to me that in countries which are now industrializing most rapidly—such as Brazil in Latin America and, in Asia, countries like India—the domestic market is growing so rapidly that it is able to absorb all of the vastly increased industrial production, particularly of consumer durable goods. These countries, even with their growing production, have not been able to keep up with the demand. Brazil is now producing some 2 million tons of steel and soon will be producing 3. Fifteen years ago it was producing next to nothing. Yet, every ounce of this is being consumed domestically, and people are still screaming for steel down there for their growing programs.

The same thing is true of other commodities that are being manufactured, including the more elaborate variety.

So it seems to me that the growing domestic market, coupled with rising incomes, and so on, is going to absorb the lion's share of manufactured goods in these countries for at least another decade or two.

Mr. ROTTENBERG. But this does not mean they will not be competitive with U.S. goods, because U.S. goods had previously been marketed in these countries before these products were produced there.

Mr. CARLSON. That is right.

Representative BOLLING. Leaving out, for the moment, policies on loans as opposed to aid, this means in effect that the one critical thing that can be done by the United States—is to solve the overhang in the agricultural and mineral field. Is that correct?

Mr. MIKESELL. I think there is a manufactured commodity import problem, too. I agree, of course, with Mr. Carlson, that their domestic economies are absorbing most of what they produce. I do happen to know of several cases in Brazil where industries have been established but have not found a sufficient domestic market as yet for efficient production. I think this was true in the case of pharmaceuticals. This, of course, raises the whole question of the desirability of a common market within Latin America or opportunities for exporting, either within Latin America or elsewhere.

But the other thing I wanted to mention was the importance of Japan. If we bought more from Japan, Japan of course would become a much better market for the products of southeast Asia. I think that there is a triangular trade problem here.

Representative Bolling. I agree with you, but I would return to the point. As far as American policy is concerned, assuming all the other difficulties of triangular relationships and effects, and leaving out for the moment the question of loans versus aid, the really critical, immediate problem, which is at least theoretically soluble, is the business of our highly developed country competing so heavily in agricultural and mineral products. This is a oversimplification, but I want to get at this one core point. Is this right or wrong?

Mr. Mikesell. I regard that as a major issue.

Representative Bolling. I will be satisfied with major.

The Chairman. I want to thank the members of the panel for the interesting papers, make one simple comment, and then raise some queries.

I was very glad Mr. Rottenberg pointed out that the term "underdeveloped" is a euphemism for "poverty." I think this is a very praiseworthy approach to vigorous speech. I have been somewhat sickened by the progressive deterioration of the English language in dealing with unpleasant realities. There used to be an honorable profession known as "undertaking"; but an undertaker has become a "mortician." I always thought that being a real estate agent was an honorable profession; but they have become "realtors." I have always thought that death was a reality, but this is now covered up under the phrase "passing on."

I am glad Mr. Rottenberg pointed out that "underdevelopment" means "poverty."

Originally, when the State Department came up with these programs, they were called "aid to backward areas." But this seemed to offend the self-esteem of the areas; so, in order to protect them and also to carry out the bureaucratic desire for bloodless language, the term "underdeveloped" was used.

If we can get in a more vigorous speech—and I think semantics are important—Mr. Rottenberg, you deserve credit for limiting some of the gobbledegook which has been introduced.

So much for my comment.

The second question I would like to phrase is this: Do you regard the primary importance of aid to underdeveloped areas as being the economic benefit to the United States or political or strategic benefit, or a humanitarian duty which the well-to-do, I think, have toward those who are poor?

Mr. Rottenberg, since you have introduced speech with muscle in it, perhaps you can reply.

Mr. Rottenberg. Put some muscle into this one, too?

I think there are a variety of grounds on which this question of foreign aid can be discussed.

The Chairman. Which is the most important?

Mr. Rottenberg. Not to select the most important one or establish a priority ranking for them, let me say I am not really competent to talk about the political and humanitarian aspects of it.

The Chairman. I see no reason why good causes have to put on self-serving raiment.

Mr. Rottenberg. I think there is one way in which, on economic grounds, foreign aid may be defensible. Perhaps it is worthwhile mentioning this. There are gains from international trade.

The CHAIRMAN. You mean as people prosper they can buy more from us?

Mr. ROTTENBERG. Yes.

First of all, there are gains in international trade in terms of specialization, division of labor, and economies of scale that make the use of resources more efficient.

The CHAIRMAN. Would you regard that as important as trying to keep the countries from going Communist?

Mr. ROTTENBERG. I think this is really a question for Members of Congress rather than university faculty members, is it not?

The CHAIRMAN. Wait a minute. You are citizens, and you cannot duck your duties as citizens by throwing the responsibility upon us. You ultimately will pass judgment upon us at the polls.

Mr. ROTTENBERG. I regard both as being important, Senator Douglas.

Mr. MIKESELL. Considering the magnitude of the assistance which, if we are not giving now, we should be giving, and its cost to the American people, I do not think this can be justified in such magnitudes on other than security grounds. On the other hand, I do believe that even if there were no cold war we would be doing a good deal. I thing we began to plan for development assistance before anyone ever heard of the cold war, during and after World War II.

The CHAIRMAN. Mr. Carlson?

Mr. CARLSON. I was going to vote for the economic criterion of these three that you mentioned and cite our recently successful deal in Western Europe. The Marshall plan is now paying off.

The CHAIRMAN. That was not in underdeveloped countries.

Mr. CARLSON. No, but I cite it as an example of an undertaking. It has reached the payoff stage. They have built up the economies to where they are operating under their own steam.

It seems to me, although I am not suggesting a Marshall plan or anything of that sort for the other areas, that some kind of undertaking on purely economic grounds, quite apart from the political or humanitarian—which tend to be rather fuzzy and about which people beat their breasts and so on—would lead to a payoff in other areas. I think we are approaching a payoff in some countries of Latin America. A country like Brazil that has gotten massive loans and aid in the last 10 years, is reaching a point now where growth is almost self-sustaining. It seems to me that this kind of pattern, on purely economic grounds, has much to commend it.

The CHAIRMAN. Perhaps you gentlemen do not want to comment on the politics of the situation, but I have heard the argument that probably it breeds communism. But there are certain disturbing factors in connection with this. If you go into past revolutions, I think you find they originated not in the most poverty-stricken regions of a country, but in the most prosperous regions. It was the poverty-stricken regions of France which were most opposed to the French Revolution and which rallied behind the monarchy. The more advanced industrial and commercial interests were for the revolution.

If you take Italy, until the last couple of years, the most retarded area, Sicily, has been the most anti-Communist. The most advanced area of Italy, the Po Valley and Lombardy, has been the most pro-Communist.

Within the various countries you will find that it is the intellectuals from the well-to-do families who tend to be Communists.

So I have wondered very much how much there is to this claim that if you eliminate poverty and develop a rising middle class, you strike a blow at communism.

Does anybody have a comment on that?

Mr. ROTTENBERG. I think what you say, Senator, is correct with reference to the countries you have mentioned. I think it is also true in the case of the Russian Revolution, where the intellectual class were also the leaders and the peasants were relatively apathetic.

This incremental piece of information is about the only comment I have to make.

Representative BOLLING. Maybe I could comment on that.

The CHAIRMAN. Yes; I wish you would.

Representative BOLLING. It seems to me that the political effect in any given situation depends on a great deal more—I am sure this is your point—than the economics of the situation. I think none of us here would think we were discussing this question in isolation from many other things. It makes very little difference how good a job we do in economics if we do not do a number of other jobs equally well or better.

I would heartily agree with your basic point, but at the same time not feel that this took away the political justification for these programs as one of three or four justifications.

The CHAIRMAN. I think we are in the extraordinary situation that we have tried to justify these programs to the people at home on the grounds that it will be good for us economically, and we have tried to justify them to people abroad on the grounds that this is a humanitarian venture. I think what we have done has been to convince the people at home that this is humanitarian and convince the people abroad that this is economic and self-serving.

Very frankly, I happen to be one who is not afraid of saying that I think it is a humanitarian obligation.

Representative BOLLING. I would accept that. I think this is a humanitarian responsibility; but it conveniently has an economic payoff. That does not disturb me the least bit.

The CHAIRMAN. The number of humanitarians in the world is relatively limited, and the proportion of any man's energy which could be devoted to humanitarian purposes is relatively limited. But I do not think we should be ashamed of having humanitarian motives, but that we should tell the people at home.

Mr. MIKESELL. It seems to me that aid must be thought of in terms of helping other countries to help themselves, and that all of the aid in the world that we might pour into a country with a weak government, a government that is not responsive to the interests and desires of the people, a government that is probably going to fall anyway—where you have a very weak and unstable internal situation—will not get us anywhere.

The CHAIRMAN. And frequently a corrupt government?

Mr. MIKESELL. And frequently a corrupt one—will not mean anything, and we might as well have thrown it in the sea. As a matter of fact, it may create a worse situation in this way: If aid temporarily subsidizes incomes, when the aid is withdrawn incomes fall, and the worse thing that can happen politically, of course, is to have a reduction in the level of living.

The aid that is going to mean something, it seems to me, in the long run, is aid to a strong government, a government that is responsive to the will of the people. We should be helping that government to do the things which are going to promote the aspirations of its people. The best example I can think of is India.

The CHAIRMAN. That is, as a country which should be helped?

Mr. MIKESELL. As a country which should be helped.

Helped to do what? Well, helped to achieve a lasting increase in the level of living, this self-generating growth process that we hear so much about. Temporary additions to consumption, temporary subsidies, I think are perhaps worse than useless politically; and also, unless we have faith in the government and the people themselves have faith in the government that we are trying to help, I think our aid is going to be politicaly undesirable.

Mr. CARLSON. Could we add the thought that the composition of the aid may make a great deal of difference? If we have a famine situation in an area where we send foodstuffs and so on, that is clearly humanitarian with political overtones. But if the components of our aid were of a kind which enabled these countries to build up their own productive capacity, then it seems to me we can reconcile any differences that might have existed.

What worries me is that sometimes aid programs are so massive in relation to a particular economy that the GNP of that economy is actually declining. Recent studies in Korea and perhaps in Libya suggest that the massive aid coming in has discouraged incentives of local entrepreneurs to set up business, with the result that growth in GNP, which is the long-range objective, is being slowed and in some cases is actually declining in relation to population growth. So the composition of the aid can make a great deal of difference.

The CHAIRMAN. In our earlier sessions this week there seemed to be a general agreement that as far as aid to the "underdeveloped countries"—in quotation marks—was concerned, Western Europe, which is rapidly getting on its feet, and particularly West Germany, should do more to help. I wonder whether the panel agrees on that?

Mr. CARLSON. You mean help in the sense of contributing additional exports of capital or do you mean in terms of humanitarian reasons?

The CHAIRMAN. Yes; or other forms.

Mr. CARLSON. Various forms?

It seems to me this is part of the hoped-for payoff in our European venture. These European countries are now at a point where they are becoming substantial exporters of capital and beginning, very modestly, perhaps, but, nevertheless beginning, aid programs of their own. This is most conspicuous in Latin America.

The CHAIRMAN. Could you not have an international program through United Nations or affiliated with the United Nations to which they would contribute? Or sort of a loose constellation of international programs bearing at least some relationship to the United Nations?

Mr. CARLSON. It would seem to me this would be worth exploring.

The CHAIRMAN. That is a cautious statement.

Mr. CARLSON. I believe it is a real thing.

The CHAIRMAN. Do you believe it is something worth advocating?

Mr. CARLSON. Yes; definitely. I was thinking it had real prospects of implementation.

Mr. MIKESELL. To me, this is one of the strongest arguments for internationalized aid. I think as our relative positions change, in terms of wealth and output—and they are changing—we should expect Western Europe, even Japan, to contribute to the underdeveloped areas. The International Bank is floating bonds in Germany and in Belgium and other countries. I think this is good.

The CHAIRMAN. But that is the guilt-edged stuff. Those are the first mortgages, so to speak. What about the second mortgages and the third mortgages?

Mr. MIKESELL. This is just an example. I think they ought to go further and give other types of aid.

The CHAIRMAN. Mr. Rottenberg?

Mr. ROTTENBERG. The United Nations, of course, already has a technical assistance administration, which is internationally financed. So to some extent other countries are participating.

The CHAIRMAN. But very inadequately financed, and on the whole, West Germany does not seem to be contributing very much.

Mr. ROTTENBERG. It is a program that could stand being doubled or trippled.

The CHAIRMAN. We have a lot of trouble down in Latin America. Brazil is rebelling against our alleged insistence on "sound financing," and the President of the Argentine is having difficulties there. I wonder if you want to comment on those issues. Have any of you specialized on Latin America, particularly South America?

Mr. ROTTENBERG. I guess Mr. Carlson has.

Mr. CARLSON. One of the elements that has been building up in these countries, especially in Brazil, is the fact that for perhaps a century, or certainly for the last 50 years, they have had chronic inflation of a very substantial amount, 15, 20 percent a year, year after year. This has built a kind of inflationism into the mentality of the people. Now we come along and say, "This is all very bad, and you have to live within your resources and stop all this nonsense about inflation." Rightly or wrongly, they feel genuinely that a part of their rapid growth, which has been one of the most rapid in the whole world in the postwar period, is due to precisely this inflation factor.

Just to mention one instance: Real wages in an industrial center like São Paulo remained almost constant over the past 10 years, because of the inflation in Brazil. This means a substantial transfer of income to the entrepreneur classes. There is emerging in Brazil a bunch of red-blooded Brazilians, you might call them, of the entrepreneural bent. They feel, "If you ask us to stop our inflation, we politically cannot stop our labor unions from pushing up wages, and this nice deal we have had is going to be stopped, and our real wages are going to start to rise."

The CHAIRMAN. Your comment is very interesting, that the people who have profited from inflation have been the business groups, entrepreneural groups in Brazil, not the wage earners.

Mr. CARLSON. With one slight qualification. The gains have been shared in this way: People have been moving into the industrial areas from depressed agricultural areas. They have been upgrading their income. But as for the industrial wages as such, they are on a level. So upgrading yourself has been a gain through the whole economy.

Mr. ROTTENBERG. On the other hand, the evidence of the American economy is that we have progressed very rapidly over the secular long run in conditions of evry substantial price stability. If you look at the price indexes in the 1790 to 1950 period and you except the wartime periods, our prices have been very stable.

The CHAIRMAN. I am very glad you say that. You are saying that if you take the longrun swings, you have increases in prices during wartime, because governments will not finance a war by taxes, but instead will do it by bond issues, or in former days by direct issue of paper money, which in turn inflates directly or indirectly the circulating medium and causes a rise in prices; but that subsequent periods of deflation have ironed out the secular increase, with the exception of this last war.

You have been studying pricing pretty closely. Has there been any real increase in prices in the last year?

Mr. ROTTENBERG. I am sorry, but I have not really examined this.

The CHAIRMAN. You are a historian and you do not come down to the present, is that right?

Mr. ROTTENBERG. That is right.

Representative BOLLING. If I remember the testimony we had earlier, this goes back to the beginning of it, not just to the 1850 period.

Mr. MIKESELL. I would like to say that I think that they can grow much faster under conditions of stability; that we have some good examples in Latin America of countries that have not grown at all for several years, largely because of the very rapid rise in prices. One, of course, is Chile, which is no secret to anyone. There has been virtually no progress there for several years. This country has experienced 30, 40, 50 percent a year price increases.

In answer to the question which you posed originally, my feeling is that we should stand firm with respect to Brazil, that we should support the recommendations of the Monetary Fund. I do not mean that the price level should not be able to move more than a few percentage points, but I think when countries are reaching the point of galloping inflation and where this is affecting their exports, their ability to earn even exchange and their allocation of resources, which is going to affect growth, we ought to hold back on assistance.

The CHAIRMAN. Mr. Rottenberg, do you agree with that?

Mr. ROTTENBERG. Yes; I do.

The CHAIRMAN. Mr. Carlson, do you agree with it?

Mr. CARLSON. In Brazil during the last 10 years prices have tripled, roughly, or have doubled at least, and yet they have a growth rate per capita of 5 and 6 percent per year in spite of this inflation.

We all agree, of course, that their growth would be more rapid if it were not for the erosive effects of inflation upon capital formation. There is no question about that.

But convince the Brazilians of this? They say, "We have the highest rate of growth in Latin America in spite of our inflation."

The CHAIRMAN. You mean the Brazilians or the business Brazilians?

Mr. CARLSON. Well, who calls the turn in Brazil, the political turns? I think the business community, myself.

Mr. MIKESELL. I would like to add that their balance-of-payments position has been steadily deteriorating, and while they have had growth in GNP, they have not had growth in exports. If they are going to continue to grow with the aid of imports as they have, it raises the question that I was discussing earlier: How are the imports going to be paid for? If they get loans, how are they going to service them? And if they do not get loans—I doubt very much and I think the Brazilians would agree that unless they can maintain something like recent levels of imports for a time, this growth is going to be affected.

As a matter of fact, from the figures I see from ECLA, growth has been affected in periods when their imports have fallen off. This growth is tied to imports to a considerable degree; their industrialization program is tied to imports. This matter of inflation and stability is closely tied to their ability to earn foreign exchange and to pay for imports and to service foreign capital.

The CHAIRMAN. We are having quite a battle in the Senate now as to whether the American aid program should be put on a long-term basis or a shorter term basis. The Senate last night, by a vote of 48 to 42, seemed to indicate that it thought future aid programs should be on a year-to-year basis, handled by appropriations rather than by authorizations, and that aid would continue for a period of years through the issuance of bonds. I suspect there will be some rollcalls coming on this rather quickly.

Do you have any advice to give?

Mr. MIKESELL. I think this is partly an administrative problem and partly relates to what you expect to do with your aid program. Obviously, if your objective is to raise the level of income and output on a self-sustaining basis over a period of years, you cannot have a large amount one year and then cut it off. This is not the way we grew. This is not the way the underdeveloped countries are going to be able to grow. They have to be capital importers for a long period.

Also, if you are talking about loans, the capacity to service loans is quite different if you assume that this is the last loan you are going to make to a country or it is ever going to get, as compared with its capacity, if you expect that year after year it is going to continue to receive loans.

Then, the kind of projects that you can go into and the whole planning that you want to do with respect to the country depends upon continuity of external assistance. For this reason, I think there ought to be in the hands of the granting and lending agencies funds so that they can look ahead for several years.

The CHAIRMAN. Several?

Mr. MIKESELL. At least.

The CHAIRMAN. How many? And, of course, appropriations which they make do not have to be expended in a given year. This constitutional provision has long since been discarded, really. Appropriations made can be later expended. We have seen that in military aid.

Is that not right, Mr. Bolling?

Representative Bolling. Certainly. This applies directly to foreign aid bills, Senator?

The Chairman. That is right.

Representative Bolling. It is not general.

The Chairman. And it applies really to development loans.

Mr. Mikesell. We can discuss this in two ways. In the first place, how long will we need to provide assistance? I think for most less developed countries this is a 20-, 25-year proposition.

The Chairman. From here to eternity—paraphrasing Mr. James Jones.

Mr. Mikesell. But administratively I do not know that it is necessary to appropriate funds for 25 years. I cannot imagine Congress doing it. I cannot imagine their going beyond, say 5 years or so.

The Chairman. Are there any other comments?

Mr. Carlson. I suppose is depends on your assumption as to whether or not foreign aid is here to stay? And I think most of us think it is. If we could agree on that initial assumption, then, it seems to me, it is indicated that longer range planning is a realistic and sensible way to do it. If you do not agree with their initial assumption—and apparently many people do not—that is another thing. Many still hope from year to year that this thing will pass from us. Perhaps that is your initial difference.

The Chairman. Do you have a question, Mr. Bolling?

Representative Bolling. There was some discussion earlier about the need for being selective in choosing the countries which we aided. In this discussion there was mention of the political factors in the countries involved. I would like to throw in another set of political factors: Granting that you should be selective, and assuming that our selection would include evaluation of the government's responsiveness to this responsibility and its ability to function over a period of time in the interests of its own people, how much weight should we give to the purely political aspect of competition with the Communists in making this kind of a decision? In other words, the possibility of their coming in and aiding or trading or investing, and so on?

Mr. Mikesell. I would just like to say that, in my opinion, the fact that India is getting some aid from the Communists does not by itself mean that we should not help India. If it does not affect the independence of the country, then that aid presumably is supplementing ours.

Representative Bolling. Let us say we have a government in an unnamed part of the world which is very questionable as to its responsiveness to the people, as to its viability, and so on. Let us say our judgment is that probably the government is going to fall ultimately. Maybe it will last only for a few years.

I would presume there would be no economic justification, no humanitarian justification, but what might be termed a political justification if it looked like its fall into Communist hands, would be expedited by any vacuum created by us in the whole field.

This is obviously not an economic question, but a political one. But is it not a question that should be considered in the whole array of problems? In other words, we aid a bad government to keep it from getting worse.

Mr. ROTTENBERG. It is quite clear there are a variety of criteria on the basis of which decisions are made on questions of this kind, and surely this ought to be one of them.

Representative BOLLING. I gather that you all agree that there should be a larger international aid program; that there should be a larger participation by the so-called developed nations than there is today. This does not exclude, I assume, continuing aid, unilaterally, but there is a general consensus that the U.N. technical assistance program should be beefed up, presumably with greater participation by the other well-off nations. Is this generally agreed?

(No response.)

Representative BOLLING. Everybody would agree that in making decisions, not in that particular program, but as perhaps unilaterally is concerned, we should be very selective and quite hard boiled in making decisions, that our aid should not go to just everybody that claims to be anti-Communist; that would be agreed?

(No response.)

Representative BOLLING. And I gather that everybody agrees at least by implication that in the past, aid programs of individual countries have quite often contained an ill-planned, unwise mix of components.

I am not talking about any short period of history. I am talking about the whole period of aid now. This is not a partisan political question.

Mr. ROTTENBERG. I do not think anyone here would disagree that some mistakes have been made.

Representative BOLLING. So that in effect what we need to do is a great deal more of careful, specific planning.

Would I be correct in an impression the small funds administered by the United Nations have often been better planned, better programed, better executed than a great many of the unilateral programs?

Mr. MIKESELL. I do not know enough about it to say.

Mr. ROTTENBERG. I suspect that each of us knows about some individual cases in which mistakes have been made by the U.N. program. The difficulty is in knowing whether more of them or more important ones have been made there.

The CHAIRMAN. Of course, the difficulty is, the Soviet Union shares in the administration of the program, to which it in fact does not contribute. Therefore, I want to modify this earlier suggestion of mine that the international program be carried out within the United Nations. In my judgment, it should be carried out under the NATO powers, with some loose affiliations with the U.N.

Representative BOLLING. I have the impression that some of the technical assistance programs carried out by the U.N., specifically in South American countries, have suffered little or not at all from this fact of the Soviet presence in the United Nations. I believe that is correct.

Mr. ROTTENBERG. There are a great many programs they administer that are not political at all.

The CHAIRMAN. I think the two programs could go on side by side, but I would not like to entrust any massive programing to the heads of the United Nations, when you know that the Soviet officials would be on the inside, at least partially on the inside of the administration of it.

Mr. Bolling, do you have any further questions?

Representative BOLLING. That is all I have.

The CHAIRMAN. I have many questions, but perhaps I should not ask them. I will merely ask one factual question, which is this:

If you take southeast Asia and India, is production increasing any more rapidly than population? Is there any real per capita increase?

Mr. MIKESELL. There has been a per capita increase, I believe, during the Indian 5-year plan. I believe in the first 5-year plan the gross national product increase was 3.4 percent a year.

The CHAIRMAN. How much was the population increase?

Mr. CARLSON. It was much less than that, fairly low, 1.5.

The CHAIRMAN. 1.5, the population increase.

Mr. CARLSON. Yes, but the population is so huge to begin with that the annual increment is terrific. Seven million new souls are generated in India.

The CHAIRMAN. So the per capita increase is less than 2 percent?

Mr. CARLSON. Yes. It is likely 1 percent, I would guess, per capita.

Mr. ROTTENBERG. There is a possibility it may even be more than that, because there is a tendency in these countries for data to be terribly untrustworthy, and especially in small production units, for output not to be counted. These estimates of national income are frequently understated for that reason.

The CHALRMAN. Do they overstate the figure or understate it?

Mr. ROTTENBERG. Understate it.

The CHAIRMAN. What has been the population?

Mr. ROTTENBERG. It is much easier to count this, especially if midwives or doctors are in presence when births take place, or if they have to be registered—and normally are—and if deaths are registered. People are easier to count than output. But the subsistence sectors of many of these economies tend to have their output understated quite often.

The CHAIRMAN. There was a figure in the morning paper estimating that the population of the world would be over 6 billion by the year 2000. The year 2000 bears about the same relationship to 1959 as 1959 does to the year I graduated from high school. So this happens within a lifetime.

Mr. ROTTENBERG. I think many of these projections depend upon what you can assume regarding the developments in the death rate.

The CHAIRMAN. The death rate is bound to go down.

Mr. MIKESELL. The death rate in these countries is falling very fast; yes. I have seen some projections for the year 2000 according to which, if you were to assume that the death rate for many of these countries were to fall to something like what we have here, and birthrates continue at the present level, you would have 9 billion or 10 billion by the year 2000.

But the hope is that with a lag of 10 or 15 years, when the death rates fall, the birthrates will fall, too. But this is only a hope.

The CHAIRMAN. The Senator from Illinois is well aware of the deep religious feelings that many people have on this issue, and I want to make it clear I am not prescribing or suggesting any remedy. But I also want to make it clear that this is a problem that the world must face, including these countries as well as ourselves and Western Europe. When you have national considerations added to this, countries wanting large population because they think it will enable them to throw their weight around internationally in a more effective fashion, you get into deep problems which perhaps we should not explore at 10 minutes of 12, because I do not think they are going to be solved by 12 o'clock.

Thank you very much for coming.

I now announce a sixth set of hearings, on "The Government Management of Its Monetary, Fiscal, and Debt Operations." These will be held both in Washington and in New York City, from July 24, on which date Secretary Anderson will testify. Monday, July 27, Mr. William McChesney Martin will testify; Tuesday, July 28, a series of witnesses from the life insurance companies will testify; and Wednesday, July 20, a witness from a savings bank. Then, the following week, we remove to New York City and will have testimony from the vice president of the Federal Reserve Bank, who manages the open market account, and from one of the dealers in Government securities. Then, later on, we will have other witnesses from the securities market.

The committee stands adjourned until Friday, July 24, 1959.

(Whereupon, at 11:55 a.m., Thursday, July 2, 1959, the committee adjourned, to reconvene at 10 a.m., Friday, July 24, 1959.)

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