289

THE BALANCE OF PAYMENTS STATISTICS

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STATISTICS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-NINTH CONGRESS

FIRST SESSION

PART 1

MAY 11, 1965

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

48-195 WASHINGTON : 1965

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C., 20402 - Price 35 cents

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*

PAUL H. DOUGLAS, Illinois, *Vice Chairman*

HOUSE OF REPRESENTATIVES	SENATE
RICHARD BOLLING, Missouri	JOHN SPARKMAN, Alabama
HALE BOGGS, Louisiana	J. W. FULBRIGHT, Arkansas
HENRY S. REUSS, Wisconsin	WILLIAM PROXMIRE, Wisconsin
MARTHA W. GRIFFITHS, Michigan	HERMAN E. TALMADGE, Georgia
THOMAS B. CURTIS, Missouri	JACOB K. JAVITS, New York
WILLIAM B. WIDNALL, New Jersey	JACK MILLER, Iowa
ROBERT F. ELLSWORTH, Kansas	LEN B. JORDAN, Idaho

JAMES W. KNOWLES, *Executive Director*

JOHN R. STARK, *Deputy Director*

MARIAN T. TRACY, *Financial Clerk*

HAMILTON D. GEWEHR, *Administrative Clerk*

ECONOMISTS

WILLIAM H. MOORE	NELSON D. McCLUNG
GERALD A. POLLACK	DONALD A. WEBSTER (Minority)

SUBCOMMITTEE ON ECONOMIC STATISTICS

WILLIAM PROXMIRE, Wisconsin, *Chairman*

SENATE	HOUSE OF REPRESENTATIVES
PAUL H. DOUGLAS, Illinois	RICHARD BOLLING, Missouri
J. W. FULBRIGHT, Arkansas	THOMAS B. CURTIS, Missouri
HERMAN E. TALMADGE, Georgia	ROBERT F. ELLSWORTH, Kansas
JACK MILLER, Iowa	

GERALD A. POLLACK, *Economist*

CONTENTS

WITNESSES

STATEMENTS

ADDITIONAL INFORMATION

TABLES

APPENDIX

THE BALANCE OF PAYMENTS STATISTICS

TUESDAY, MAY 11, 1965

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMIC STATISTICS,
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10:05 a.m., pursuant to call, in room AE-1, the Capitol, Senator William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Douglas; Representative Ellsworth.

Also present: Gerald A. Pollack, staff economist; James W. Knowles, executive director; and Hamilton D. Gewehr, administrative clerk.

Senator PROXMIRE. The Economic Statistics Subcommittee of the Joint Economic Committee will come to order.

The Bernstein committee, which has been meeting for 2 years, has published its report on balance of payments statistics. This is a very important and controversial report.[1]

The report recommends that we stop measuring the balance of payments deficit in the manner in which it is being measured now, and promotes the use of a new concept which gives sharply different numerical results.

Mr. Bernstein, you and your committee are among the most distinguished economists in the world, and certainly among the outstanding experts in this particular field. I think you know that after these hearings, we will have the views of Government and other witnesses who oppose the views of your committee. We will try to obtain as balanced and comprehensive a picture of the recommendations as possible.

I want to stress the great importance of this report before we begin.

The policies determined by Congress relating to the balance of payments cover a great many fields: The foreign aid program, participation in financing international organizations, tax policy, policies related to military operations, monetary policy, and a variety of Treasury policies, as well as many private banking and business policies.

In the past few months, we have been reminded forcibly over and over again how very serious and fundamental are the considerations of the balance of payments situation. A number of Senators have changed their votes on vital policies of this Government, because of their concern about our balance of payments situation.

Generally, the wisdom of these policies must be based on accurate and comprehensive statistics in regard to balance of payments. This

---

[1] "The Balance of Payments Statistics of the United States, A Review and Appraisal," Report of the Review Committee for Balance of Payments Statistics to the Bureau of the Budget, April 1965. Available from Superintendent of Documents, U.S. Government Printing Office, $1.50.

study—the Bernstein study—explores in depth and detail how these statistics can best be improved. It goes far beyond a simple recommendation of the statistical change that has caught the headlines.

I invite attention, for example, to the recommendations in the Summary of Findings and Recommendations of the Review Committee Report, which I read briefly:

> Benchmark data against which to check the accuracy of current estimates are out of date or lacking for many types of international transactions. For example, no thorough study of travel expenditures has ever been made.
>
> The current estimate of foreigners' earnings from their investments in U.S. corporate stocks is based on estimates of their holdings derived in part from an analysis of U.S. withholding tax returns for the year 1949. No census of U.S. direct investments abroad has been taken since 1957, although such investments are estimated to have nearly doubled since then.
>
> A large statistical discrepancy—the "net errors and omissions" item—indicates an inability to identify or measure a large volume of international transactions, and to interpret developments.
>
> For instance, the deficit settled by official transactions diminished by about $1 billion from 1962 to 1963. Yet the available data on trade, services, and capital transactions identify only about $250 million of this improvement. Larger changes, favorable to the extent of about $750 million, remain unidentified in net errors and omissions.

In addition to this area of prospective improvement, the study pointed out, and I quote:

> It is very difficult to analyze the significance of changes in trade without proper and reliable indexes of export and import prices. Yet such basic information is not available in a dependable form.

I read another paragraph from this analysis:

> A good deal of significant work on balance of payments analysis is being done by economists in universities and in business. For them, as well as for other users of the statistics, it is essential to have a thorough understanding of the coverage, composition, and derivation of every item in the balance of payments tables and related data.
>
> The last balance of payments manual was published by the Commerce Department in 1952 and is now seriously out of date. A new version is urgently needed. Other Federal agencies engaged in the collection of data on international transactions should also publish new descriptions of their methodology. A comprehensive account of the way in which merchandise trade statistics are compiled was last published by the Bureau of the Census in 1950. The Treasury and Federal Reserve System have never published a full account of their systems of data collection.

So it is apparent that there are a great many areas where improvement in the statistics can very greatly help us base our judgments in this field on more accurate and comprehensive information.

I attempted to call to the attention of my colleagues this excellent and very competent report, by having printed in the Congressional Record the recommendations and conclusions from the report. The recommendations alone are 20,000 words. I think that this monumental work is going to serve us well. I am hopeful that we can have as critical a consideration of it this morning as possible, and a followup on it.

I think that it would be useful to insert at this point of the record the Review Committee's summary of findings and recommendations.

Summary of Findings and Recommendations

The Review Committee for Balance of Payments Statistics was charged with the responsibility for considering the adequacy of the U.S. balance of payments statistics and making recommendations for their improvement. It was not asked to determine the causes of the U.S. balance of payments deficit or to recommend remedies for dealing with it.

The Committee has reviewed in detail the purposes for which balance of payments statistics are needed; the scope and quality of the statistics; the ways in which they are collected, processed, and presented to the public; and the important conceptual problem of defining a balance of payments surplus or deficit, which affects both the presentation of the statistics and their interpretation.

We have found that improvements in the statistics and their presentation are urgently required if the data are adequately to meet present and prospective needs for their use in economic analysis and in government policy making and business planning. Substantial improvement can be achieved fairly promptly with relatively modest additional resources. The Committee urges that a program be set in motion as soon as possible to implement the recommendations presented in this Report.

URGENT AND GROWING NEED FOR INFORMATION

It is appropriate to state at the outset that the Committee agrees with U.S and foreign experts that the balance of payments statistics of the United States are considerably better than those of most other countries. Furthermore, they are about as good as other U.S. economic statistics collected by similar methods. The statistics currently collected and published provide a reliable basis for appraising the U.S. payments situation. It is no reflection on the statisticians and economists who compile and analyze these data to say that there is a present and prospective need for more accurate and detailed balance of payments statistics, and for improved presentation and fuller analysis of them.

Many improvements have been made in the collection and presentation of the data over the past 10 years. At the same time, the international transactions of the United States have become more complex, and also more important for both the domestic economy and the world economy. The U.S. dollar plays a strategic role in the international monetary system as the principal reserve currency. It is the currency most widely used in international trade and payments. More than other countries, the United States must weigh carefully the possible effects, both at home and abroad, of a wide variety of alternative economic and financial policies. The need for accurate measurement and careful analysis of U.S. international transactions has been dramatized by the large and persistent deficit in the U.S. balance of payments in recent years. For all these reasons, it is essential to collect and compile full and accurate statistics on the international transactions of the United States. The detailed information that they provide will permit early diagnosis of important new developments and emerging problems.

In recent years, policy decisions in a variety of fields—credit and interest rates, price and wage guideposts, the use of aid funds, military procurement and expenditure, to name just a few—have been determined to an important extent by balance of payments considerations. Sometimes lack of information and lack of knowledge of the reliability of the data have hampered policy making. Although there is no reason for thinking that wrong policy decisions have been made because of deficiencies in the data, it is possible that this could occur in the future. While the basic data and a good deal of detailed information are presently available, collected by many agencies through a wide variety of means, the Committee believes that measures should be taken now to improve our balance of payments statistics.

The methods by which these statistics are collected and compiled result in significant gaps in coverage and possibilities of error. To some extent the gaps and errors occur in measuring all types of international transactions. They are probably much greater in percentage terms for some kinds of service transactions and capital movements than for other items. But even for merchandise exports and imports, they could well be substantial in absolute amount. While some of the data have been revised and improved from time to time, there is a need for more continuous and systematic review.

Benchmark data against which to check the accuracy of current estimates are out of date or lacking for many types of international transactions. For example, no thorough study of travel expenditures has ever been made. The current estimate of foreigners' earnings from their investments in U.S. corporate stocks is based on estimates of their holdings derived in part from an analysis of U.S. withholding tax returns for the year 1949. No census of U.S. direct investments abroad has been taken since 1957, although such investments are estimated to have nearly doubled since then.

New kinds of international transactions have emerged in recent years for which the present data collection system may be inadequate. The expenditures of the U.S. Government for aid and military transactions are a case in point. Another example is the Euro-dollar market, in which U.S. participation involves an intricate network of transactions.

A large statistical discrepancy—the "net errors and omissions" item—indicates an inability to identify or measure a large volume of international transactions, and to interpret developments. For instance, the deficit settled by official transactions diminished by about $1 billion from 1962 to 1963. Yet the available data on trade, services, and capital transactions identify only about $250 million of this improvement. Larger changes, favorable to the extent of about $750 million, remain unidentified in net errors and omissions. And the sum of gross errors and omissions in individual accounts is probably considerably larger than the net discrepancy.

It is true that many improvements in the data have been made in recent years. For example, direct investment reports to the Commerce Department, now mandatory, have become more complete, and valuable supplementary information is being collected. The Treasury "Foreign Exchange Forms," on which capital movements other than direct investments are reported, have been substantially revised and reporting is now much fuller and more accurate. The Customs Service has been attempting to improve the import statistics by assiduously checking and correcting import declarations. Reporting by Government agencies of their own international transactions is now much better than before.

Despite the great improvements that have been made—and continue to be made—in collecting and compiling the data, they have not kept pace with the growing need for balance of payments statistics. This is not a temporary need arising from the balance of payments deficit. The need for better data will endure and increase even after the present payments problem is solved. Full and accurate data are needed to analyze the causes of a surplus as well as of a deficit. With full recognition of the advances that have been made in the balance of payments statistics over the past decade, the Committee believes that further steps must be taken now to assure an even better flow of statistics in the future.

MEASUREMENT OF THE SURPLUS OR DEFICIT

The definition and measurement of a balance of payments surplus or deficit is a matter of analysis rather than accounting. Particularly complex problems arise in the case of the United States because it is a reserve currency country and a banking center. No single number can adequately describe the international payments position of this country at any time. Nevertheless, users of the statistics have legitimate needs for summary indicators of the position.

The main summary indicator that is now used in official publications is the "balance on regular types of transactions." This measure of surplus or deficit is based on a concept of international liquidity which the Committee believes to be unsatisfactory in principle and difficult to apply in practice. We find that a different concept, stressing the distinction between the transactions of monetary authorities here and abroad and those of all other transactors, provides a more appropriate basis for summarizing the position and a better starting point for analysis. Therefore, we recommend that the main summary indicator now used be replaced by the "balance settled by official transactions." Existing data are good enough to yield a measurement of the surplus or deficit on either concept that is probably accurate within a few hundred million dollars in any year.

In the present international financial system, the key demarcation in international transactions is between those of the monetary authorities and all other transactions. Leading countries have established fixed parities for their currencies and have undertaken by international agreement to maintain exchange rates within prescribed margins of those parities. The monetary authorities use reserves to prevent a decline below this limit and acquire reserves to prevent a rise above this limit in the foreign exchange value of their currencies. In effect, the monetary authorities fill the gap between the private demand for and the private supply of foreign exchange, and the size of this gap, measured by the transactions of the monetary authorities, provides the most useful starting point for balance of payments analysis.

In U.S. statistics, the transactions of the monetary authorities, which may be termed "reserve transactions," are shown by changes in the reserve assets of U.S. monetary authorities and changes in all U.S. liabilities to foreign monetary authorities. The large prepayments of official debts to the United States in recent years should also be regarded as official settlement items, undertaken to avoid a drain on reserves. Thus, the main measure of deficit or surplus should be the balance financed by official settlements, the latter comprising reserve transactions and debt prepayments.

This definition of the surplus or deficit differs from the concept now used in official publications. Changes in the reserve assets of U.S. monetary authorities are, of course, now treated as settlement items, helping to finance the surplus or deficit. But changes in U.S. liquid liabilities to all foreigners—including foreign commercial banks and other private foreigners, as well as foreign monetary authorities—are also included among the settlement items. In the view of the Committee, changes in liabilities to others than monetary authorities usually represent ordinary capital movements and should be treated in the same way as changes in U.S. private banking and money market claims.

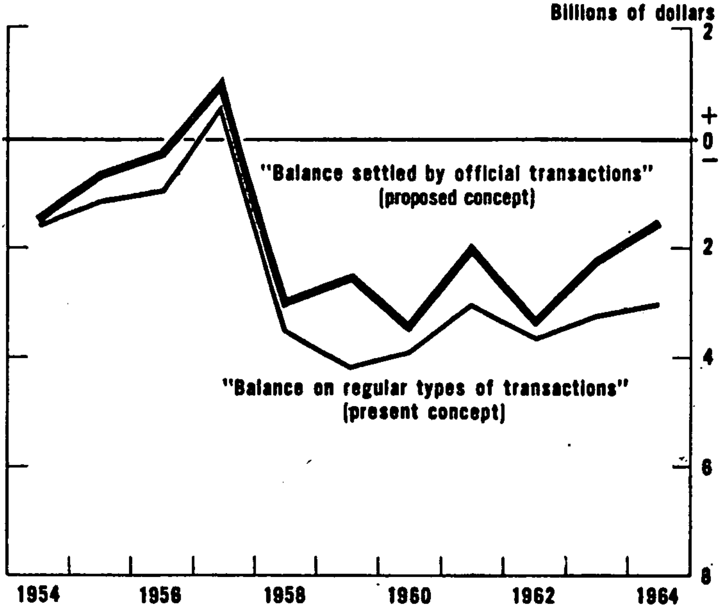
The key role of the dollar in international trade and finance, and the resulting diversity of U.S. transactions with the rest of the world, make it difficult to measure the surplus or deficit whatever concept is used. The official settlements concept involves fewer problems of measurement than any alternative. However, changes in U.S. short-term liabilities to foreign commercial banks pose special problems for the application of the official settlements concept because they sometimes include transactions specifically undertaken or induced by the monetary authorities, which involve transfers of dollar claims from or to the monetary authorities. At certain times, the change from quarter to quarter in the balance settled by official transactions can be analyzed only by considering also these officially-induced changes in U.S. short-term liabilities to foreign commercial banks. Therefore, while changes in U.S. liabilities to foreign commercial banks usually represent ordinary capital transfers, they should be shown separately because at times they are particularly affected by the transactions of the monetary authorities.

On the other hand, for purposes of calculating the overall deficit or surplus, no distinction should be made among the different types of claims that are included in U.S. liabilities to foreign monetary authorities. While distinctions based on the liquidity of liabilities as well as of assets are important, they are less important than the fundamental difference between transactions undertaken by the monetary authorities and transactions undertaken by all others. The Committee recommends including among the liabilities of a reserve character not only the short-term assets held in the United States by foreign monetary authorities, but also their holdings of nonmarketable U.S. Treasury securities denominated in dollars or in other currencies.

The measuring of the surplus or deficit by official settlements seems appropriate to the position of the United States as a banking and financial center in which foreign banks and business enterprises hold working balances and invest funds. This concept of the surplus or deficit has two additional advantages over the concept now used. First, it can be made internationally symmetrical, so that, after taking account of net additions to the world's gold reserves, surpluses would equal deficits if the same definition were used by all countries. Second, the official settlements concept provides a measure of the surplus or deficit that is less subject to errors and omissions, as U.S. data on liabilities to foreign monetary authorities are more reliable than those on liabilities to other foreigners.

The recommended summary indicator of the U.S. payments position shows a deficit from 1958 to 1964 that is lower by about $900 million a year than the measurement now used, averaging $2.6 billion a year instead of $3.5 billion. The two measures are compared in Table 1 and Chart 1. Despite the fact that the deficit is smaller under the Committee's definition than under the present definition, the payments deficit to be eliminated is still considerable.

CHART 1.
SUMMARY INDICATORS OF THE U.S. BALANCE OF PAYMENTS POSITION



Note: See notes to Table 1. Comparable quarterly data for 1959–64 are shown in Chart 9.5, page 120.

TABLE 1.—*Summary indicators of the U.S. balance of payments position, 1954–64*

[In billions of dollars]

Period	Recommended by the Committee [1]			Presently used in official statistics [2]			Difference: [1] column (1) less column (4)
	Balance settled by official transactions	Official transactions: Debt prepayments	Official transactions: Reserve transactions	Balance on regular types of transactions	Special Government transactions	Reduction in reserve assets and increase in liquid liabilities	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1954	−1.5		1.5	−1.5		1.5	0.1
1955	−.7		.7	−1.2		1.2	.5
1956	−.2		.2	−.9		.9	.7
1957	+1.1		−1.1	+.5		−.5	.6
1958	−3.0		3.0	−3.5		3.5	.5
1959	−2.5	0.4	2.1	−4.2	0.4	3.8	1.7
1960	−3.5	.1	3.4	−3.9	.0	3.9	.5
1961	−2.0	.7	1.3	−3.1	.7	2.4	1.0
1962	−3.3	.7	2.7	−3.6	1.4	2.2	.3
1963	−2.3	.3	1.9	−3.3	.6	2.6	1.0
1964 [3]	−1.5	.1	1.4	−3.1	.3	2.8	1.5
AVERAGES							
1954–57	−.3		.3	−.8		.8	.5
1958–64	−2.6	.3	2.3	−3.5	.5	3.0	.9

[1] The Committee's concepts are explained in Chapter 9. The difference shown in column (7) equals the increase in "liquid" U.S. liabilities to international and foreign official nonmonetary institutions, to foreign commercial banks, and to other private foreigners, plus the increase in certain "nonliquid" U.S. Government liabilities to foreign official nonmonetary institutions.

[2] Data on "special Government transactions" have not been published for years prior to 1960. They are shown above as nil through 1958, and as comprising debt prepayments of $435,000,000 in 1959. In 1963–64, U.S. Government nonmarketable medium-term convertible securities are here included in "liquid liabilities" rather than in "special Government transactions."

[3] Preliminary.

Details do not always add to totals because of rounding.

PRESENTATION OF THE DATA

In the opinion of the Committee, the Commerce Department is as prompt as it is possible to be in announcing and publishing the quarterly balance of payments data. A preliminary estimate of the payments deficit, based on partial figures for some important categories of transactions, is released within 6 weeks of the end of the quarter. The full data are published in the *Survey of Current Business* 3 months following the end of the quarter to which they refer. An attempt to speed up the publication of the quarterly balance of payments would risk the use of unreliable figures available only in a preliminary form in order to gain a week or two at most. Needless to say, the Government agencies that are concerned with balance of payments problems and policies have access to the preliminary figures as they become available.

The Committee attaches great importance to improving the presentation of balance of payments statistics in official publications. The Office of Business Economics (OBE) in the Department of Commerce publishes three major tables on the balance of payments each quarter in the *Survey of Current Business.* Table 3, although gradually modified over time as required by changing conditions, retains as far as possible continuity with the tabular presentations of the past. On the other hand, Tables 1 and 2, which present data on a seasonally adjusted basis, are in completely different form. Their reconciliation with Table 3 is very difficult for experts and virtually impossible for the general reader.

The Committee believes that it would be desirable to provide a single summary table which would present the main features of the U.S. balance of payments in a shorter and clearer form than the three summary tables now published. Annual data from 1954 to 1964, arranged in the recommended format, are shown in Table 2.

TABLE 2.—*U.S. Balance of Payments, 1954–64*

[In billions of dollars]

Type of transaction	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964 p
A. Goods and services, except transfers under military grants [net receipts (+)]	1.8	2.0	4.0	5.7	2.2	0.1	3.9	5.6	5.1	5.7	8.2
A.1 Merchandise exports, adjusted	12.8	14.3	17.4	19.4	16.3	16.3	19.5	19.9	20.6	22.0	25.2
A.2 Transport and travel receipts	1.8	2.1	2.3	2.8	2.5	2.5	2.6	2.7	2.8	3.0	3.3
A.3 Military receipts	.2	.2	.2	.4	.3	.3	.3	.4	.7	.7	.8
A.4 Investment income and related receipts	2.4	2.6	2.9	3.1	3.1	3.4	3.6	4.3	4.9	5.1	5.9
A.5 Miscellaneous service receipts	.6	.7	.8	.9	1.0	1.0	1.1	1.1	1.2	1.3	1.3
A.6 Merchandise imports, adjusted	−10.4	−11.5	−12.8	−13.3	−13.0	−15.3	−14.7	−14.5	−16.1	−17.0	−18.6
A.7 Transport and travel payments	−2.0	−2.4	−2.7	−2.9	−3.1	−3.4	−3.7	−3.7	−4.0	−4.4	−4.6
A.8 Military payments	−2.6	−2.9	−2.9	−3.2	−3.4	−3.1	−3.0	−3.0	−3.0	−2.9	−2.8
A.9 Investment income and related payments	−.4	−.5	−.6	−.7	−.7	−.9	−1.0	−.9	−1.1	−1.3	−1.4
A.10 Miscellaneous service payments	−.5	−.5	−.6	−.6	−.7	−.7	−.7	−.8	−.8	−.8	−.9
B. Remittances and pension payments (net)	−.6	−.6	−.7	−.7	−.7	−.8	−.7	−.7	−.7	−.8	−.8
C. U.S. Government grants and capital, except military grants	−1.6	−2.2	−2.4	−2.6	−2.6	−2.4	−2.8	−3.5	−3.7	−3.9	−3.7
C.1 Nonmilitary grants and long-term credits	−2.0	−2.3	−2.3	−2.6	−2.8	−2.7	−2.9	−3.8	−4.0	−4.1	−4.3
C.2 Scheduled repayments of long-term credits	.5	.4	.5	.7	.5	.6	.6	.6	.6	.6	.6
C.3 Foreign-currency balances and short-term claims [net increase (−)]	−.1	−.3	−.6	−.6	−.3	−.4	−.5	−.3	−.2	−.4	−.0
D. Foreign official capital, except claims of monetary institutions [net increase in foreigners' assets (+)]	.0	−.1	.0	.3	.3	.4	.6	.4	.4	.3	.0
D.1 Investments and claims of foreign governments, except monetary institutions	.0	.0	.0	.1	.0	.2	.2	−.1	.1	.4	.2
D.2 Investments and claims of international nonmonetary institutions	.0	−.1	.0	.3	.3	.1	.4	.5	.3	−.2	−.2
E. Long-term private capital [net increase in U.S. assets (−); net increase in foreigners' assets (+)]	−.7	−.5	−2.0	−2.9	−2.6	−1.4	−2.1	−2.2	−2.7	−3.3	−4.1
E.1 U.S. direct investments abroad	−.7	−.8	−2.0	−2.4	−1.2	−1.4	−1.7	−1.6	−1.7	−1.9	−2.3
E.2 Transactions in foreign securities	−.2	.0	−.4	−.5	−1.3	−.7	−.7	−.8	−1.0	−1.1	−.7
E.3 Other U.S. investments abroad	−.1	−.3	−.2	−.4	−.2	−.3	−.2	−.3	−.3	−.6	−1.3
E.4 Foreign direct investments in the U.S.	.1	.2	.2	.2	.1	.2	.1	.1	.1	−.0	.0
E.5 Transactions in domestic securities	.1	.4	.3	.2	−.0	.6	.3	.3	.1	.2	−.1
E.6 Other foreign investments in the U.S.	.0	.0	.0	.0	.0	.0	.0	.0	.0	.1	.2
F. Short-term private capital, except claims of foreign commercial banks reported by U.S. banks [net increase in U.S. assets (−); net increase in foreigners' assets (+)]	−.6	−.2	−.2	0	−.2	.1	−1.6	−1.3	−.5	−.3	−1.7
F.1 U.S. claims on foreigners reported by U.S. banks	−.5	−.2	−.4	−.3	−.4	−.1	−1.0	−1.1	−.3	−.7	−1.5
F.2 Other U.S. claims on foreigners	−.2	−.0	−.1	−.0	.0	.0	−.4	−.4	−.2	.0	−.6
F.3 Foreign claims on the U.S., except claims of foreign commercial banks reported by U.S. banks	.0	−.0	.3	.3	.2	.1	−.2	.3	.1	.5	.4
G. Short-term claims of foreign commercial banks reported by U.S. banks [net increase (+)]	.0	.4	.4	.1	0	1.1	.1	.6	−.1	.4	1.4
H. Net errors and omissions [net receipts (+)]	.2	.5	.5	1.2	.5	.4	−.8	−1.0	−1.1	−.3	−.9
J. Balance settled by official transactions (sum of A through H, equal, with opposite sign, to sum of K and L)	−1.5	−.7	−.2	1.1	−3.0	−2.5	−3.5	−2.0	−3.3	−2.3	−1.5
K. Special intergovernmental transactions [net receipts (+)]	------	------	------	------	------	.4	.1	.7	.7	.3	.1
K.1 Advance repayments of long-term debt to the U.S.	------	------	------	------	------	.4	.1	.7	.7	.3	.1

L. Reserve transactions [net increase in U.S. assets (−)]	1.5	.7	.2	−1.1	3.0	2.1	3.4	1.3	2.7	1.9	1.4
L.1 U.S. holdings of gold, convertible currencies, and other reserve assets [net increase (−)]	.3	.0	−.3	−.8	2.3	1.1	1.7	.7	.9	.3	−.1
L.2 IMF position [increase in drawing rights (−)]	.2	.1	−.6	−.4	.0	−.0	.4	−.1	.6	.0	.3
L.3 U.S. liabilities to foreign official monetary institutions [net increase (+)].[1]	1.0	.5	1.1	.1	.7	1.1	1.3	.7	1.1	1.6	1.2
Memoranda: Transactions excluded above:											
I. U.S. military grants (excluded from line C.1) and transfers under military grants (excluded from lines A.1, A.2, A.3, and A.5)	3.4	2.6	2.6	2.4	2.3	2.0	1.8	1.5	1.5	1.5	n.a.
II. Reinvested earnings of the foreign subsidiaries of U.S. firms (excluded from lines A.4 and E.1)	.7	1.0	1.2	1.4	.9	1.1	1.3	1.1	1.2	1.6	n.a.
III. Reinvested earnings of the U.S. subsidiaries of foreign firms (excluded from lines A.9 and E.4)	.2	.2	.2	.2	.2	.2	.2	.2	.2	.2	n.a.

n.a. Not available.
p Preliminary.
1 Includes some changes in liabilities to foreign official nonmonetary institutions, but these are believed to be small.

NOTE.—For further explanation of items, see detailed tables in Chapter 10. Details do not always add to totals because of rounding. Some items have been revised in recent years and corresponding revisions have not been made for earlier years.

Detailed tables clearly keyed to the summary table should also be published quarterly. The Committee feels that such detailed tables should be shown for U.S. merchandise trade; for services, investment income and remittances; for military receipts and payments; for Government grants and capital; for other types of capital transactions except claims of monetary institutions; and for U.S. reserves, IMF position, and liabilities to foreign official monetary institutions. Such detailed quarterly tables are indispensable to economic analysis.

The Office of Business Economics compiles a considerable amount of information on the balance of payments that is not published quarterly in the *Survey of Current Business*. Some of the information appears on a regular basis in the form of annual articles on investment, trade, travel, etc. Some of it is published only in a statistical supplement that has been issued about once in 4 years. Revised data appear from time to time, although it is difficult in some instances to get a continuous series in convenient form because of the long interval between publication of the statistical supplements. The Committee believes that a yearbook on balance of payments statistics, appearing soon after the revised data for the previous year are all available, would provide a convenient form in which to assemble in one place the detailed information that cannot conveniently be shown in the quarterly tables, including much information now published in special articles at various times during the year.

INTERPRETATION AND ANALYSIS

An understanding of the payments position of the United States requires a study of the constituents of the balance of payments, from quarter to quarter and over a period of years, eliminating the effects of seasonal fluctuations and making allowance for cyclical and adventitious factors. The ultimate purpose of such studies is to determine the causes of changes in the major constituents of the balance of payments as well as their effects on the overall position, and to project trends. Such analyses can be used by the Government in formulating its policies and by business in making trade and investment decisions.

Balance of payments statements summarize a complex matrix of transactions. Any credit item (e.g., exports) may be related to several debit items (e.g., imports, Government grants and credits, U.S. direct investments abroad, U.S. bank loans, etc.). An important part of balance of payments analysis consists of identifying these inter-relationships. But the statistics alone can never identify them, and standard statistical presentations should not attempt to do so. Gross flows of each type should be shown wherever practicable and analysis of net impacts should be reserved for special tabulations and special articles where the hypotheses and qualifications involved can be clearly stated.

Because the balance of payments statistics cannot by themselves provide answers to analytical questions, it is important that the developments which they reflect be analyzed carefully. Such analysis must be done largely by those who are familiar with the transactions, the data, and their limitations. The Balance of Payments Division in the Office of Business Economics, with its long experience and great understanding of the data, can make a unique contribution to these analytical studies, and should be staffed to make a greater contribution than is possible with its present resources. Policy agencies—particularly the Treasury, the Federal Reserve System, and the Council of Economic Advisers—should give even greater attention than they now do to continuous and systematic analysis of the data and to studies of the probable effects of alternative policies. Other agencies having important international operations, such as the Agency for International Development and the Department of Defense, should also expand and coordinate analytical studies of their own operations.

It should be emphasized that analysis of the balance of payments is very difficult if the data are not properly articulated, complete, and accurate, and if the ancillary information to be used in analysis is not available. Compilers and users of trade statistics, for example, have no firm basis for ascertaining how accurately merchandise imports and exports are valued. Yet a 5 percent error in either would amount to about a billion dollars a year. Furthermore, it is very difficult to analyze the significance of changes in trade without proper and reliable indexes of export and import prices. Yet such basic information is not available in a dependable form.

A good deal of significant work on balance of payments analysis is being done by economists in universities and in business. For them, as well as for other users of the statistics, it is essential to have a thorough understanding of the coverage, composition, and derivation of every item in the balance of payments tables and related data. The last balance of payments manual was published by the Commerce Department in 1952 and is now seriously out of date. A new version is urgently needed. Other Federal agencies engaged in the collection of data on international transactions should also publish new descriptions of their methodology. A comprehensive account of the way in which merchandise trade statistics are compiled was last published by the Bureau of the Census in 1950. The Treasury and Federal Reserve System have never published a full account of their systems of data collection and compilation, although partial information is given in notes in the *Treasury Bulletin* and in the Federal Reserve Board's *Supplements to Banking and Monetary Statistics.*

IMPROVING THE BALANCE OF PAYMENTS DATA

Economic data are almost always imperfect. They necessarily involve approximations, omissions, and errors. Such deficiencies are inherent in the collection of statistics of all kinds, including balance of payments statistics. Nevertheless, the importance of the balance of payments requires that greater efforts should be made to improve the accuracy and coverage of the statistics that are collected and that special efforts should be made to secure a better knowledge of the sources of remaining errors and omissions. It is toward these two main aims that the Committee's recommendations on the statistics themselves are primarily directed.

Most existing statistical reporting programs have been carefully devised and tested over a period of years. The quality of the data actually obtained depends, however, to a large extent on the way in which each reporter fills out the reporting form. He cannot do this well unless he knows how, and unless he can obtain the relevant information from his records. Consultation between Government technicians and individual reporters should be carried on much more extensively and systematically than at present. For many kinds of transactions, particularly those on capital movements, a relatively small number of reporters account for the bulk of the reported totals. An individual approach to each of these large reporters at least every 2 years is desirable.

Reporting instructions should be clarified and adapted from time to time to fit the changing nature of the international transactions being measured. Compact and comprehensible reporting manuals should be provided, explaining proper reporting procedures and illustrating typical or complex reporting problems. Senior executives of reporting firms (and reporting Government agencies) must be shown why accurate statistical reporting of their international transactions is required for determining public policy.

The statisticians should consult systematically not only with those who report the data, but also with outside experts who use the statistics. A panel of business economists might be able to offer particularly valuable advice on improving the data because of their familiarity both with particular kinds of transactions and with the analytical purposes for which data are needed.

While the main improvement in the quality of statistics will probably come from better reporting, some changes of coverage are also necessary. Where statistical reports are voluntary, as for tourism, improved sample coverage should be sought. Cutoff points for required reports should be systematically reviewed periodically. In some cases, it may be appropriate to reduce coverage rather than to increase it. For example, the cutoff for quarterly reports on foreign assets and liabilities of nonbanking concerns was recently increased in order to release from reporting requirements many firms whose international transactions are very small and have inconsequential effects on reported totals.

Special surveys are needed to establish bench marks in areas where more frequent reporting is impracticable or must be limited to a sample of reporters. This will permit the testing of the quality of the data and may reveal new avenues of improvement. At present, the best bench-mark survey in the balance of payments field is the census of direct U.S. business investments in foreign countries, conducted by the OBE for the years 1950 and 1957. This periodic census has developed a wealth of important information and has led to great improvement in the quality of quarterly and annual reports. The Committee is disappointed that funds for a 1964 census were not provided by the Congress. It urges that such a census be taken for 1965, and that surveys of this kind be made periodically in this and a number of other fields at approximately 5-year intervals.

A special survey should be made promptly to check the quality of current data on merchandise trade. At present, little information is available on the sources of error and their magnitude, from the balance of payments point of view, in trade statistics. A survey is needed to test the extent to which shipments are reported in conformity with present instructions, at actual transactions value, or at fair market value in the case of shipments among corporate affiliates. Improved sample surveys, carefully planned and pretested, should also be made of certain kinds of personal expenditure, notably travel expenditures, and the overseas expenditures of Government civilian and military personnel.

The possibility should be explored of obtaining benchmark or supplementary balance of payments data through established surveys presently conducted for other purposes. Surveys of consumer expenditures, for example, might include a question on foreign travel. Some questions on foreign claims and liabilities might be attached to commercial bank call reports. The comprehensive survey recommended by the National Wealth Inventory Planning Study would produce valuable information on U.S. foreign claims and liabilities and on related income flows.

Other new sources of data and ways of cross-checking data should be developed. It may be possible to collect needed additional data on capital flows directly from certain financial intermediaries. This need not involve onerous reporting burdens. It might be useful, for example, to resume the practice, abandoned a few years ago, of collecting periodic reports from the U.S. paying agents of foreign issuers of dollar bonds on outstandings, redemptions, and changes in ownership between U.S. and foreign holders. Withholding tax returns of U.S. corporations and nominees should be used periodically, as they last were for 1949, to check foreign portfolio holdings of U.S. corporate stocks and income therefrom. A check on estimates of U.S. holdings of foreign securities (including their area distribution) and income received from them might be obtained from tabulations of the returns on which U.S. taxpayers claim credit for taxes withheld abroad.

In compiling and checking the accuracy of U.S. balance of payments statistics, greater use should be made of statistics collected in foreign countries. While only modest and gradual progress is to be hoped for in this direction, much more should be attempted than at present. Already, U.S. statisticians make use of Canadian data on travel, transportation, and some securities transactions. Cooperative efforts of this kind should be extended, and more use should be made of facilities available through the International Monetary Fund, the Organization for Economic Cooperation and Development, and the Bank for International Settlements.

The most promising possibilities lie in the banking field. It is much easier to ascertain the deposit liabilities of banks in a foreign country to U.S. residents by using data collected from those banks than by seeking out the U.S. depositors. Measurement of the foreign assets and liabilities of central banks and other monetary authorities is especially susceptible to cooperative statistical efforts, even though confidentiality may require a lag in supplying some of the details. For this purpose, it might be necessary to use the intermediary services of the International Monetary Fund or the Bank for International Settlements.

STATISTICAL RESOURCES AND ORGANIZATION

The U.S. Government's system of decentralized data collection and analysis has great advantages, but leadership and provision of adequate resources are required to make it function effectively. The collection of the balance of payments data is undertaken by a number of different agencies which report their own transactions or secure information about private transactions from reporters. The Office of Business Economics collects a good deal of original data itself, adjusts the data collected by other agencies to balance of payments concepts where necessary and possible, and compiles the balance of payments from these statistics.

Improvement of the balance of payments statistics will require the cooperation of a number of Government agencies. It is necessary, however, for one agency to exercise leadership in seeing that the statistics meet the standards required for their use by the Government and by others. The Office of Statistical Standards in the Bureau of the Budget should assume this leadership under its overall responsibility for the quality of U.S. Government statistics. It should make sure that data on the entire range of U.S. international transactions are systematically evaluated on a continuing basis. It should help other agencies to obtain the information and the resources needed to improve the balance of payments statistics. It should seek professional consensus within the Government on questions involving the compilation and presentation of the data.

Within the agencies actually working with balance of payments statistics, the greatest burden must inevitably fall on the Balance of Payments Division of the Office of Business Economics. In the nature of its work, it is the agency most apt to discover deficiencies in the statistics. Its own analysis of the balance of payments continuously brings to light the areas in which additional information is required. To perform its function effectively, the Balance of Payments Division must have more personnel. Additional senior economists are needed to maintain contacts with firms reporting on international transactions, and with economists and other users of the statistics outside the Government; to undertake systematic and critical evaluation of the data; and to analyze current balance of payments developments. Some additional intermediate level economists and clerical personnel are also required. A modest increase in the staff would ameliorate the present serious overload of work and permit substantial improvement in the collection, presentation, and analysis of the statistics.

Other agencies also need some increase in the staff engaged in balance of payments work. The Treasury needs a few more staff members to consult at regular intervals with reporters of large international financial transactions, to undertake periodic surveys, to analyze the balance of payments with particular reference to its financial aspects, and to participate in the program for international cooperation on balance of payments problems and policies. To perform its function in the balance of payments field, the Office of Statistical Standards in the Bureau of the Budget also needs strengthening.

While the Committee has not made a special study of the processing methods used by the various agencies in handling balance of payments statistics, it is aware that greater use of automatic processing equipment would facilitate the work of collecting, compiling, and analyzing the data. Use of data processing equipment, which has increased in the last year or two, is essential for making seasonal adjustment and correlation analysis. The routine tabulations currently made by hand should be converted to mechanical processing wherever this can be done at less cost and with greater efficiency.

The Committee has focused mainly on what the Government can do to improve the balance of payments statistics and their presentation. It is appropriate, however, to remind users of the statistics—both within and outside the Government—that better analysis requires not only better statistics but also a better understanding of the nature and limitations of the data. No tabular arrangements can provide answers to analytical questions. It is difficult to read trends currently in individual statistical series (e.g., exports) without additional information on particular transactions and circumstances. It is even more difficult to analyze the interrelationships among different kinds of transactions, and their connection with domestic and foreign developments. While balance of payments statistics are an essential ingredient of such analysis, they must be used with technical competence and a generous admixture of experience and commonsense.

TABLE 3.—*Condensed summary of the U.S. balance of payments, 1958-64, with reconciliation items*

[In billions of dollars]

	1958	1959	1960	1961	1962	1963	1964 [1]
Goods, services, and remittances [net receipts (+)]	1.5	−.7	3.2	4.9	4.3	4.9	7.4
Merchandise exports	16.3	16.3	19.5	19.9	20.6	22.0	25.2
Merchandise imports	−13.0	−15.3	−14.7	−14.5	−16.1	−17.0	−18.6
Services, except military, and remittances (net)	1.4	1.2	1.1	2.0	2.2	2.1	2.8
Military payments and receipts	−3.1	−2.8	−2.7	−2.6	−2.3	−2.2	−2.0
U.S. Government grants and capital (net) (excluding debt prepayments)	−2.6	−2.4	−2.8	−3.5	−3.7	−3.9	−3.7
Foreign official capital, except claims of monetary institutions (net)	.3	.4	.6	.4	.4	.3	.0
Long-term private capital (net)	−2.6	−1.4	−2.1	−2.2	−2.7	−3.3	−4.1
Short-term private capital, except claims of foreign commercial banks (net)	−.2	.1	−1.6	−1.3	−.5	−.3	−1.7
Short-term claims of foreign commercial banks (net)	.0	1.1	.1	.6	−.1	.4	1.4
Net errors and omissions	.5	.4	−.8	−1.0	−1.1	−.3	−.9
Balance settled by official transactions	−3.0	−2.5	−3.5	−2.0	−3.3	−2.3	−1.5
Less: Selected inflows of foreign capital:							
Short-term claims of foreign commercial banks	.0	1.1	.1	.6	−.1	.4	1.4
Other "liquid" foreign private claims	.2	−.0	−.2	.1	.1	.4	.3
Foreign official capital except claims of monetary institutions	.3	.4	.6	.4	.4	.3	.0
Plus: Other adjustments, net [2]	.0	−.2	.1	.0	.1	.1	.1
Balance on regular types of transactions	−3.5	−4.2	−3.9	−3.1	−3.6	−3.3	−3.1

[1] Preliminary.
[2] Includes cumulative effects of rounding.

Mr. Bernstein, you may proceed any way you wish with your statement.

STATEMENTS OF EDWARD M. BERNSTEIN, CHAIRMAN, REVIEW COMMITTEE FOR BALANCE OF PAYMENTS STATISTICS, AND PETER B. KENEN, MEMBER, REVIEW COMMITTEE FOR BALANCE OF PAYMENTS STATISTICS; ACCOMPANIED BY JOHN REYNOLDS, STAFF DIRECTOR

Mr. BERNSTEIN. Mr. Chairman, we are very glad to have the opportunity to discuss with you the report on the Balance of Payments Statistics of the United States. As you have already pointed out, it is essential to have a wider public understanding of the U.S. balance of payments. The hearings before this committee will be invaluable for this purpose. They will bring together the whole range of expert opinion on U.S. balance of payments statistics, and they will focus attention on the need not only for better statistics, but on their use with technical competence, and with commonsense.

Our Committee was concerned with the quality and the presentation of the balance of payments statistics of the United States. It was also concerned with the definition of the deficit.

We regret that popular interest in the definition of the deficits tends to overshadow the huge amount of work that we have done, mainly with the help of the technicians of the United States, in appraising the quality of the statistics.

I believe that the statement that Professor Kenen is about to make about the statistics and their presentation will help to redress this one-sided view. When he has completed his statement, I will make a statement on the problems of measuring the deficit, and then Mr. John Reynolds, who has been our staff director, as well as Professor Kenen and I, will be glad to answer any questions.

Senator PROXMIRE. Thank you. Dr. Kenen?

Mr. KENEN. Mr. Chairman, the Review Committee for Balance of Payments Statistics has concluded that the overall quality of U.S. balance of payments statistics is relatively high. They are better than the balance of payments statistics of most countries, and about as good as other U.S. economic statistics. Nevertheless, even the most important accounts, such as the series on merchandise exports and imports, contain certain errors, of uncertain magnitude. Many of the the service accounts are incomplete and inaccurate because of the difficulty of securing the underlying data. The private capital accounts, both United States and foreign, are known to exhibit very large errors; some types of private capital transactions may not be covered at all.

There has been a steady improvement in the absolute quality of the statistics—both in coverage and accuracy. The improvement of the data, however, has not kept pace with the growing need, by Government and business, for complete and accurate balance of payments statistics. Nor has the reporting system been sufficiently enlarged to keep pace with institutional changes. In consequence, there has been a relative deterioration in quality—relative, that is, to our needs.

The difficulties of interpretation and analysis posed by these deficiencies in the data are most dramatically illustrated by the large "net errors and omissions" item, and its striking shifts from quarter to quarter and year to year. From 1962 to 1963, the deficit settled by official transactions—the definition recommended by the Review Committee—diminished by $1 billion, but the recorded transactions identify a bare $250 million of this improvement; larger changes, favorable to the extent of about $750 million, remain unidentified in net errors and omissions. From 1960 to 1964, the "errors and omissions" item implied an annual average net payment of over $800 million. And this must be stressed: The gross errors and omissions in the individual accounts on trade, services, and capital movements, which are the basis for analyzing the balance of payments, were considerably larger than this net discrepancy.

No one is more acutely aware of these statistical deficiencies than the small and able group of senior economists in the Balance of Payments Division of the Commerce Department—the group responsible for collecting and processing the data and presenting them in the balance of payments accounts. The Review Committee relied heavily upon their experience in assessing the quality of the statistics. With them, it concluded that the key to improving the balance of payments statistics is to secure fuller and more accurate reporting of international transactions by business firms and by Government agencies.

The Review Committee has also recommended specific measures for developing more recent and comprehensive benchmarks, for sample surveys to appraise data quality, and for the wider use of machine tabulations. It has also urged that the data be improved through greater international cooperation in collecting and checking data. Foreign countries and international institutions, such as the International Monetary Fund, the Bank for International Settlements, and the Organization for Economic Cooperation and Development, can contribute to this task.

The Review Committee's many recommendations for improving the statistics cannot all be carried out at once. In fact, a great deal of preparatory work must precede the implementation of some of its recommendations, especially those concerned with new benchmarks. But there should be no delay in enlarging the staff of the Commerce Department, and of other Government agencies concerned with these statistics, in order to carry out these recommendations and also to conduct a more thorough economic analysis of the U.S. balance of payments.

One of the related recommendations of the Review Committee is that the Office of Statistical Standards in the Bureau of the Budget take the leadership in improving the statistics. In particular, it should secure interdepartmental cooperation in maintaining and improving the underlying data.

Finally, there is an urgent need for an up-to-date publication on methodology to explain how the data are collected and processed. This guidebook should be issued as soon as possible. I might add, Mr. Chairman, that as a user of the statistics in my professional capacity as a college teacher and research economist, I am in great need of such a manual to protect me against error in the use of the figures.

The balance of payments of the United States is, at best, difficult to comprehend. There is a vast array of data to be studied. The difficulty has increased in recent years as the form of the principal balance of payments table has been changed to take account of new types of transactions. In the opinion of the Review Committee, the balance of payments accounts should be presented in a simpler form that will facilitate understanding and analysis of the many international transactions in which this country is engaged.

The Review Committee has recommended the use of a standard balance of payments table that differs in several respects from that which is published now. It does so on the basis of a very long examination of several alternatives proposed by the many experts with whom we spoke and to whom we wrote. The proposed table, shown on page 128 of the report (reproduced as fold-in, facing this page) is somewhat shorter than the present table, and it groups the principal types of transactions more logically. The entries are shown on 39 lines as compared with the 54 lines in the present table 3 of the Survey of Current Business.

Let me summarize the principal changes proposed by the Review Committee.

(*a*) Transport and travel receipts are placed together, as are transport and travel payments; you will find them in lines A–2 and A–7 in the proposed table.

(*b*) Investment income is shown on a single line, and includes fees and royalties related to direct investment.

(*c*) U.S. Government grants and capital, except military grants, are grouped in a single major category; which is section C of the standard table.

(*d*) Capital transactions with foreign governments, other than the monetary authorities, and those with international nonmonetary institutions, are placed in a new major category; this is section D on page 128.

(*e*) Long-term private capital, both United States and foreign, is placed in a single category, section E of the table, with the constituent accounts shown separately.

(*f*) Short-term private capital, both United States and foreign, except the dollar claims of foreign commercial banks, is placed in a single category, section F of the table, with the constituent accounts shown separately.

(*g*) The short-term claims of foreign commercial banks are placed in a separate category, G, and finally, the deficit is defined on line J of the table by official transactions, and special intergovernmental capital transactions currently comprising prepayments of debt.

The Review Committee believes that this proposed new standard table, though much reduced in size, has sufficient detail for a first examination of the balance of payments. There is, however, a clear need for more detail, and this is supplied in the report by a series of supplementary tables, which actually furnish more information than has been published heretofore. The Review Committee recommends that detailed supplemental tables, keyed to the standard table, be provided for each major group of transactions. These detailed tables, Mr. Chairman, begin on page 133 of the report, and continue on succeeding pages.

TABLE I. U.S. Balance of Payments, 1962–64

[In millions of dollars]

Type of transaction	Calendar years 1962	Calendar years 1963	Calendar years 1964p	Unadjusted 1962 III	Unadjusted 1962 IV	Unadjusted 1963 I	Unadjusted 1963 II	Unadjusted—Con. 1963—Continued III	Unadjusted—Con. 1963—Continued IV	Seasonally adjusted 1962 III	Seasonally adjusted 1962 IV	Seasonally adjusted 1963 I	Seasonally adjusted 1963 II	Seasonally adjusted 1963 III	Seasonally adjusted 1963 IV	Type of transaction
A. Goods and services, except transfers under military grants [net receipts (+)].		5,685	8,209			1,343	1,638	523	2,181			1,208	1,446	1,304	1,727	**A. Goods and services, except transfers under military grants [net receipts (+)].**
A.1 Merchandise exports, adjusted		21,989	25,219			4,959	5,704	5,205	6,121			4,990	5,472	5,610	5,917	A.1 Merchandise exports, adjusted.
A.2 Transport and travel receipts		3,012	3,345			650	812	816	734			738	747	756	771	A.2 Transport and travel receipts.
A.3 Military receipts		659	758			164	244	103	148			181	206	117	155	A.3 Military receipts.
A.4 Investment income and related receipts		5,089	5,873			1,224	1,172	1,122	1,571			1,303	1,233	1,232	1,321	A.4 Investment income and related receipts.
A.5 Miscellaneous service receipts		1,271	1,328			307	310	308	346			323	319	322	307	A.5 Miscellaneous service receipts.
A.6 Merchandise imports, adjusted		−16,996	−18,638			−3,929	−4,227	−4,314	−4,526			−4,037	−4,212	−4,368	−4,379	A.6 Merchandise imports, adjusted.
A.7 Transport and travel payments		−4,380	−4,626			−815	−1,171	−1,455	−939			−1,054	−1,087	−1,126	−1,113	A.7 Transport and travel payments.
A.8 Military payments		−2,897	−2,807			−747	−731	−711	−708			−747	−731	−711	−708	A.8 Military payments.
A.9 Investment income and related payments		−1,255	−1,368			−289	−296	−302	−368			−288	−295	−326	−346	A.9 Investment income and related payments.
A.10 Miscellaneous service payments		−807	−875			−181	−179	−249	−198			−201	−206	−202	−198	A.10 Miscellaneous service payments
B. Remittances and pension payments (net)		−826	−830			−206	−207	−198	−215			−209	−209	−206	−202	**B. Remittances and pension payments (net).**
C. U.S. Government grants and capital, except military grants		−3,879	−3,705			−932	−1,250	−766	−931			−919	−1,180	−826	−954	**C. U.S. Government grants and capital, except military grants.**
C.1 Nonmilitary grants and long-term credits		−4,077	−4,266			−1,003	−1,120	−896	−1,058			−1,010	−1,075	−976	−1,016	C.1 Nonmilitary grants and long-term credits.
C.2 Scheduled repayments of long-term credits		643	572			121	131	163	228			141	156	183	163	C.2 Scheduled repayments of long-term credits.
C.3 Foreign-currency balances and short-term claims [net increase (−)].		−445	−11			−50	−261	−33	−101			−50	−261	−33	−101	C.3 Foreign-currency balances and short-term claims [net increase (−)].
D. Foreign official capital, except claims of monetary institutions [net increase in foreigners' assets (+)].		285	38			2	0	99	184			5	25	102	153	**D. Foreign official capital, except claims of monetary institutions [net increase in foreigners' assets (+)].**
D.1 Investments and claims of foreign governments, except monetary institutions.		467	214			67	68	114	218			67	68	114	218	D.1 Investments and claims of foreign governments, except monetary institutions.
D.2 Investments and claims of international nonmonetary institutions.		−182	−176			−65	−68	−15	−34			−62	−43	−12	−65	D.2 Investments and claims of international nonmonetary institutions.
E. Long-term private capital [net increase in U.S. assets (−); net increase in foreigners' assets (+)].		−3,341	−4,064			−1,130	−1,013	−276	−922			−1,190	−916	−456	−779	**E. Long-term private capital [net increase in U.S. assets (−); net increase in foreigners' assets (+)].**
E.1 U.S. direct investments abroad		−1,888	−2,297			−563	−509	−145	−671			−618	−477	−235	−558	E.1 U.S. direct investments abroad.
E.2 Transactions in foreign securities		−1,104	−677			−522	−535	−99	52			−487	−500	−169	52	E.2 Transactions in foreign securities.
E.3 Other U.S. investments abroad		−581	−1,279			−19	−128	−114	−320			−59	−98	−134	−290	E.3 Other U.S. investments abroad.
E.4 Foreign direct investments in the U.S.		−5	26			−5	47	40	−87			−5	47	40	−87	E.4 Foreign direct investment in the U.S.
E.5 Transactions in domestic securities		185	−52			−17	74	38	90			−17	74	38	90	E.5 Transactions in domestic securities.
E.6 Other foreign investments in the U.S.		52	215			−4	38	4	14			−4	38	4	14	E.6 Other foreign investments in the U.S.
F. Short-term private capital, except claims of foreign commercial banks reported by U.S. banks [net increase in U.S. assets (−); net increase in foreigners' assets (+)].		−262	−1,677			139	−310	223	−314			114	−340	128	−164	**F. Short-term private capital, except claims of foreign commercial banks reported by U.S. banks [net increase in U.S. assets (−); net increase in foreigners' assets (+)].**
F.1 U.S. claims on foreigners reported by U.S. banks		−742	−1,528			77	−402	74	−491			62	−492	−41	−271	F.1 U.S. claims on foreigners reported by U.S. banks.
F.2 Other U.S. claims on foreigners		8	−579			−16	−130	25	129			−26	−70	45	59	F.2 Other U.S. claims on foreigners.
F.3 Foreign claims on the U.S., except claims of foreign commercial banks reported by U.S. banks.		472	430			78	222	124	48			78	222	124	48	F.3 Foreign claims on the U.S., except claims of foreign commercial banks reported by U.S. banks.
G. Short-term claims of foreign commercial banks reported by U.S. banks [net increase (+)].		438	1,415			386	75	−31	8			186	75	49	128	**G. Short-term claims of foreign commercial banks reported by U.S. banks [net increase (+)].**
H. Net errors and omissions [net receipts (+)]		−339	−893			32	59	−267	−163			−118	−11	−267	57	**H. Net errors and omissions [net receipts (+)].**
J. Balance settled by official transactions (sum of A through H, equal, with opposite sign, to sum of K and L).		−2,239	−1,507			−366	−1,008	−693	−172			−923	−1,110	−172	−34	**J. Balance settled by official transactions (sum of A through H, equal with opposite sign, sum of K and L).**
K. Special intergovernmental transactions [net receipts (+)]		326	122			25	34	241	26							**K. Special intergovernmental transactions [net receipts (+)].**
K.1 Advance repayments of long-term debt to the U.S.		326	122			25	34	241	26							K.1 Advance repayments of long-term debt to the U.S.
L. Reserve transactions [net increase in U.S. assets (−)]		1,913	1,382			341	974	452	146							**L. Reserve transactions [net increase in U.S. assets (−)].**
L.1 U.S. holdings of gold, convertible currencies, and other reserve assets [net increase (−)].		348	−95			78	122	168	−20							L.1 U.S. holdings of gold, convertible currencies, and other reserve assets [net increase (−)].
L.2 IMF position [increase in drawing rights (−)]		30	266			−46	2	59	15							L.2 IMF position [increase in drawing rights (−)].
L.3 U.S. liabilities to foreign official monetary institutions [net increase (+)].[1]		1,535	1,214			309	850	225	151							L.3 U.S. liabilities to foreign official monetary institutions [net increase (+)].[1]
Memoranda: Transactions excluded above:																Memoranda: Transactions excluded above:
I. U.S. military grants (excluded from line C.1) and transfers under military grants (excluded from lines A.1, A.2, A.3, and A.5).		1,482	n.a.			447	675	134	226							I. U.S. military grants (excluded from line C.1) and transfers under military grants (excluded from lines A.1, A.2, A.3, and A.5).
II. Reinvested earnings of the foreign subsidiaries of U.S. firms (excluded from lines A.4 and E.1).		1,565	n.a.			n.a.	n.a.	n.a.	n.a.							II. Reinvested earnings of the foreign subsidiaries of U.S. firms (excluded from lines A.4 and E.1).
III. Reinvested earnings of the U.S. subsidiaries of foreign firms (excluded from lines A.9 and E.4).		236	n.a.			n.a.	n.a.	n.a.	n.a.							III. Reinvested earnings of the U.S. subsidiaries of foreign firms (excluded from lines A.9 and E.4).

p Preliminary. n.a. Not available.
[1] Includes some changes in liabilities to foreign official nonmonetary institutions, but these are believed to be small.

Note: When regularly published, this table would show data for the 3 most recent calendar years and the 6 most recent quarters.

48-195 O - 65 - pt. 1 (Face p. 16)

First, the standard balance of payments, broken down by regions, is presented in table III on page 133, with some modification in the present regional classification. Merchandise trade by end-use categories follows as table IV; then services, investment income, and remittances as table V; then a separate table, VI, on military receipts and payments; then table VII, on Government grants and capital; table VIII on foreign official capital, except the claims of monetary institutions. There follow three more tables on long-term private capital, on short-term private capital, and, finally, on U.S. reserves, the IMF position, and U.S. liabilities to foreign official monetary institutions.

It should be pointed out that the Balance of Payments Division of the Commerce Department and the Treasury Department have pioneered in collecting and publishing much of the detailed data that the Review Committee has included in its supplemental tables. The data, however, are now published in many different places and at irregular intervals. The regular publication of these statistics in supplementary balance of payments tables would permit a considerable simplification of the standard table, while also providing regularly, in adequate detail and convenient form, the statistical materials essential for an analysis of the balance of payments.

The Review Committee has also recommended the publication of a yearbook on balance of payments statistics. At present, the Commerce Department publishes a Balance of Payments Statistical Supplement to the Survey of Current Business which appears at irregular intervals. The latest issue of the supplement carries data to 1961; a previous issue carried data to 1954. Additional materials on investment, travel, and transportation, other important sectors of the balance of payments, and on related matters, are also published at various times of the year in the Survey of Current Business. In the opinion of the Review Committee, a yearbook would be the best way to furnish back data, as most recently revised, and to furnish much of the information currently published in scattered articles. The yearbook should also supply notes on methodology, announcing any changes in the collection, coverage, or processing of the U.S. balance of payments statistics.

Mr. Bernstein will continue with a summary of other parts of the Review Committee's work.

Mr. BERNSTEIN. Among its other tasks, the Review Committee was directed to consider the present method of measuring the deficit. The concept now used by the Balance of Payments Division is that the deficit shows a change in the "liquidity" of the United States as a result of international transactions.

By this definition, the financing of the deficit—and this is the measure of the deficit—is shown by changes in U.S. reserves; that is, gold, foreign exchange, and the net position in the International Monetary Fund, in U.S. liabilities to foreign official institutions except nonmarketable, nonconvertible, medium term obligations of the Treasury which are not regarded in one of the definitions of the deficit as liquid, and in short-term and liquid liabilities to foreign individuals, companies, and banks.

The Balance of Payments Division also uses another definition of the deficit, that on regular types of transactions. The deficit on regular types of transactions is measured by all of the items in the liquidity concept, but, in addition, it also includes as part of the measure of the deficit, and that means they are excluded from regular transactions, prepayments on military sales, nonscheduled payments on foreign debts to the U.S. Government, and changes in foreign holdings of nonmarketable, nonconvertible, medium-term securities issued by the Treasury to foreign monetary authorities.

That is to say, although these are not liquid liabilities, they are also not regular transactions, and, therefore, they are included as part of the measure of the deficit on regular transactions.

The Review Committee does not regard these concepts of the deficit and the settlement items that measure the deficit as appropriate. In the present international monetary system, leading countries have established fixed parities for their currencies and have undertaken by international agreement to maintain exchange rates within prescribed margins of those parities.

They do this by acquiring and using foreign exchange reserves, by buying and selling gold, and by undertaking transactions with the IMF. Governments may also arrange special transactions, such as prepayment of intergovernmental debts, to help meet payments deficits without drawing down their reserves.

The Review Committee recognizes all such transactions as official settlements to finance the payments deficit, including in U.S. reserve liabilities all special issues of Treasury securities to foreign monetary authorities, whether they are convertible or not.

The Review Committee's definition differs in several respects from the deficit on regular types of transactions, one of the measures now emphasized by the Balance of Payments Division. The Review Committee includes in ordinary transactions above the line—that means they are part of the transactions that give rise to ordinary receipts and payments, and therefore they are excluded from the settlement items below the line—prepayments on military sales which it regards as not essentially different from prepayments on any other U.S. export orders.

It includes in ordinary transactions—and thus excludes from the settlement items that measure the deficit—changes in all private holdings of short-term and liquid dollar assets.

There is no more reason for treating an increase in foreign holdings of such assets as settlement items than for regarding the acquisition of similar claims by U.S. banks and business as settlement items. In both cases, the transactions are undertaken for the benefit of those who invest such funds abroad. They should, therefore, be treated as capital movements rather than as settlement items.

There is one other category that the committee excludes from the deficit, and that is changes in the dollar holdings of foreign official institutions, other than monetary authorities. That would include the World Bank and the Inter-American Development Bank, but it would not include the International Monetary Fund or the European Fund, or the BIS. Perhaps it would help to show how our treatment of these holdings of dollars; that is, the acquisition of dollars by these international institutions, differs from the way it is done now.

At present, when the World Bank finds it convenient to issue bonds, because it plans to make loans in the coming year and the market for bonds is attractive, it may sell a hundred million dollars of bonds.

Suppose they are all sold to residents of the United States. Its dollar holdings would be up $100 million. As it hasn't as yet lent the funds, it may invest them in short-term Treasury bills or other Treasury securities.

Under the definition that the Balance of Payments Division uses, the sale of these bonds by the World Bank is a capital outflow from the United States, because our residents have bought securities of an international institution. The increase in the dollar holdings of the World Bank is treated as part of the measure of the deficit because they are liquid funds.

We propose to regard the acquisition, the sale of the bonds to our citizens, as a capital outflow. Because the World Bank is not a monetary institution, we regard the use of the funds to acquire Treasury bills, or other Treasury obligations, as a capital inflow. Therefore, when a new issue is made by the World Bank, it has no net effect on the deficit, in the first instance.

Of course, when the World Bank lends the money, there will be a capital outflow as it sells or redeems the Treasury obligations, and lends the funds. However, if the funds are spent in this country, we might have an export of goods and we would thus offset all or part of the capital outflow.

What we have really done is to place the World Bank on a disbursement basis rather than on a securities issue basis. I might add that the World Bank believes that this is a more practical interpretation of how their business is done.

The Review Committee regards our concept of the deficit, particularly in its treatment of private funds, as a more realistic reflection of how balance of payments surpluses and deficits are actually settled.

We regard our treatment of private holdings of foreign assets as in conformity with the dynamics of an expanding world economy. Under the definition used by the Balance of Payments Division, with a zero deficit—that is to say, if the balance of payments deficits on regular types of transactions were zero—there could be no accumulation of dollars by foreign individuals, companies, and banks, unless such accumulations were offset by an equal increase in U.S. monetary reserves, or a decrease in reserve liabilities to foreign monetary authorities.

A zero balance of payments deficit by the present definition would not provide the world with additional dollars for working balances and liquid investments to match the growth in world trade and payments.

By the Review Committee's definition, however, a zero deficit measured by official settlements, would be consistent with the continued growth of privately held liquid dollar assets by foreigners and privately held claims against foreigners by U.S. banks and business.

It is worth noting that the economists of the Balance of Payments Division do not argue that a proper balance of payments for the United States, that is to say, one that we could sustain in the long run without running into problems, even under their definition, is a zero deficit, because they do recognize the practical need for a growth in foreign private holdings of liquid dollar assets.

Now, it is not for me to say what is a proper balance of payments, if anyone can say with assurance, under the present definition. I have mentioned that the Balance of Payments Division doesn't argue that it is a zero deficit.

Three years ago, when I spoke to the U.S. Counsel of the International Chamber of Commerce, I said in response to a question that I believed that a proper deficit under our present definition would be about $500 million. I think that in the opinion of people who are well informed, a proper deficit under the present definition is between $500 million and a billion dollars. It depends on how you——

Senator PROXMIRE. When you are talking about deficit, now, are you talking about which definition——

Mr. BERNSTEIN. In the present definition.

Senator PROXMIRE. Under the present definition, fine.

Mr. BERNSTEIN. Under the present definition. Under our definition, no——

Senator PROXMIRE. How can you say there would be any figure, $500 million or a billion? Wouldn't it depend on these other things, these other considerations?

Mr. BERNSTEIN. Right. I was giving you the estimates, Senator, that have been given. I was about to add, when you foresaw the point I was going to make, that that would depend upon the behavior of certain constituent items which we regard as capital movements but which are treated as settlement items, as part of the measure of the deficit, under the present definition.

It is unlikely, for example, that the $400 million or $300 million that has been the average capital inflow through official nonmonetary institutions will remain at that figure. There have been certain transactions that have made the figure rather larger than it will usually be.

Over a longer period it is more likely to be nearer zero, and that would of course change the difference between the present definition and our definition. That is why I would rather give a range of the proper deficit under the present definition. I think those who support the present definition should be asked to estimate the average deficit that could be sustained over a long period without causing serious payments difficulties.

Another advantage of the Review Committee's definition is that it would be symmetrical if used by all countries. If every country used the deficit as the official settlements definition, the sum of the deficits and surpluses of all countries would be zero, except for the addition of gold to monetary reserves. Each country would have a small surplus if the increment of gold were reasonably equally divided.

There might also be certain statistical discrepancies—cases where foreign exchange is held by the monetary authorities, and is not reported as a liability to a central bank or treasury. If the present definition, the one the Balance of Payments Division uses, were used by all countries, the sum of the surpluses and deficits would be negative, by a large but uncertain amount, representing the increase in private holdings of liquid assets abroad.

It is difficult to see how governments can cooperate effectively on policies to maintain a satisfactory pattern of international payments, with such an inherently inconsistent definition of the surplus or deficit.

In fact, if everybody used the present definition, when there is a strong pattern of world payments, without any exchange market deficits or surpluses by our definition, all countries would seem to be in deficit by the Balance of Payments Division definition.

It is sometimes argued that an increase in foreign private dollar holdings should be regarded as settlement items, not as ordinary capital inflow, because such holdings could easily move into official holdings, and thus become reserve liabilities of the United States.

There is no reason for thinking that this is any more true of foreign private holdings of dollars and other liquid assets than, say, the liquid assets held by domestic corporations, or if you wish, the resources held by U.S. banks.

Such funds can also move out and get into the hands of foreign monetary authorities. Even in the most difficult times that foreign countries had in earning enough dollars for their most urgent needs, foreign private holdings of dollars rose, and they rose because they were required for working balances and for liquid investments. From 1945 to 1964, foreign private holdings of dollars and other banking claims rose in every year except 1948—and that was a very tough year—when they fell by $26 million, and in 1960 when they fell by $65 million.

Notice, the growth has been steady. Not always the same amount each year, but it has grown in periods of European crises, it has grown in periods of U.S. crises. It has grown because, in fact, world trade and investment has grown, and foreigners do need dollars for that purpose.

Now, contrast this with the greater volatility in foreign holdings of U.S. corporate securities, which are not in the settlement items. There were net sales of U.S. corporate stocks by foreigners from 1946 to 1949, and that means, of course, that the dollars got into the hands of the foreign monetary authorities. These were net sales of U.S. corporate stocks by foreigners again in 1958, and once more, to the extent of $350 million, in 1964.

To put it bluntly, I should say that from 1945 on the data show that when foreigners hold U.S. corporate stocks, dollars are more likely to move from such investment into the hands of foreign monetary authorities than out of the private liquid dollar assets which the Balance of Payment Division regards as in the nature of a settlement item in the balance of payments.

Senator PROXMIRE. Do you have a statistical analysis to show that?

Mr. BERNSTEIN. I will put it into the record.

Senator PROXMIRE. Will you? Fine.

Mr. BERNSTEIN. I have the figures here, if that is what you mean.

Senator PROXMIRE. Oh, yes; that would be very helpful.

Mr. BERNSTEIN. I will leave it with the reporter. It is out of the Treasury Bulletin.

(The table furnished follows:)

Private foreign short-term claims reported by U.S. banks, 1945–64

[In millions of dollars]

End of year	Outstanding at end of year	Increase during year	End of year	Outstanding at end of year	Increase during year
1945	2,678.5		1955	4,726.6	391.1
1946	2,922.2	243.7	1956 [1]	5,392.7	666.1
1947	2,972.8	50.6	1957 [1]	5,665.3	272.6
1948	2,947.1	−25.7	1958	5,890.9	225.6
1949	3,001.5	54.4	1959	6,999.2	1,108.3
1950	3,456.5	455.0	1960	6,934.4	−64.8
1951	4,041.2	584.7	1961 [1]	7,737.3	802.9
1952	4,245.6	204.4	1962	7,815.4	78.1
1953	4,308.4	62.8	1963	8,729.7	914.3
1954	4,335.5	27.1	1964	10,501.8	1,772.1

[1] Revised figures. Increase during year includes amounts excluded from private accounts in 1956 and 1957, reclassified as official, and amount not previously reported included in data for 1961.

Source: Treasury Bulletin, April 1965, p. 83.

Mr. BERNSTEIN. Of course dollar funds do move between private holdings and those of the monetary authorities. In fact, one way monetary policy acts on the balance of payments is through the inducement to hold more or less funds abroad.

That is to say, monetary policy acts on the holdings of U.S. banks and business in foreign countries, it acts to some extent on foreign private holdings in this country. There is nothing unusual in that.

Movements of dollar funds between commercial banks and the monetary authorities, say through forward exchange transactions, are a special case. This can happen when the Bundesbank offers a special deal to German commercial banks to induce them to acquire dollars by giving them a higher interest return through a favorable relationship of the spot to the forward exchange rate. But the amounts involved are not of such magnitude, either in any one period or cumulatively, to justify treating all changes in foreign commercial bank holdings of short-term dollar assets as settlement items.

Now, nevertheless, because changes in the dollar holdings of foreign commercial banks are important for many reasons, and they may at times be closely related to reserve movements, the Review Committee has placed this item in a separate category of the balance of payments where it can be quickly and easily identified.

Senator, if I am not prolonging this too much, I would like to make an important point about the present treatment of dollar holdings of foreign commercial banks. In my opinion, the study of the behavior of foreign commercial banks' holdings of U.S. dollars—the study in depth of changes and rates of change in such holdings, why they increase a good deal sometimes and less at other times, how they move from quarter to quarter—the study of all these problems has been inhibited by putting such holdings below the line as settlement items.

By doing this, changes in the dollar assets of foreign commercial banks are treated as a passive response resulting from the balance of payments, instead of being active forces of their own, with an independent pattern of behavior, and which have a positive effect on the balance of payments.

The arbitrary aspects of treating foreign private claims on U.S. banks as in the nature of reserve liabilities, while disregarding claims by U.S. banks, which are to some extent the counterpart of such foreign deposits, is generally recognized by bankers.

When I say bankers, I mean not just central bankers, though I am going to quote an article by four central bankers, but I mean all bankers. In an article in the Monthly Review of the Federal Reserve Bank of New York, August 1963, four central bankers suggested that—and now I am quoting from that article:

> After an equilibrium in the U.S. payments position is restored, it might be worthwhile considering whether some, if not all, of the short-term banking claims of the United States might not be offset against such short-term banking liabilities.

I want to make it quite clear that I am not claiming the support of the authors for our definition of the deficit. They may very well not like our point of view, particularly as we are recommending the use of our definition before an equilibrium in the U.S. balance of payments has been reached.

Our committee, the Review Committee, recognized the close relation between some foreign claims of U.S. banks and the foreign liabilities of U.S. banks, and I could document this at great length.

Nevertheless, the Review Committee found it neither desirable nor feasible to net out specific short-term claims of U.S. banks against some of their specific short-term liabilities. We do not think it is feasible to go through the accounts and say, "Look, this Japanese bank has a deposit of $20 million in the United States. We know this Japanese bank has to keep this $20 million deposit, because they have $50 million of loans from U.S. banks." We may know that at one time, the Central Bank of the Philippines had a hundred million dollars or more on deposit in U.S. banks as time deposits, pledged against loans to the Philippines. The claims of the Philippines were regarded as part of our reserve liabilities, but the liability of the Philippine Central Bank to our banks was not.

The Review Committee does not believe our statisticians can go around looking at each banking account and offsetting such specific items. Instead, the Review Committee came to the conclusion that the best way would be to use the official settlements as the measure of the surplus or deficit. This involves treating both U.S. banking claims on foreigners and U.S. banking liabilities to foreigners, other than to monetary authorities, as capital transactions.

We treat the dollar holdings of treasuries and central banks differently, as reserve accounts. We do recognize the special importance of claims of foreign commercial banks reported by U.S. banks, and we do that by placing such transactions in a separate major category.

The Review Committee has also set up a separate item showing changes in short-term claims against foreigners reported by U.S. banks.

The Review Committee's balance of payments table provides in clear form the data needed for analyzing changes in short-term claims of foreign commercial banks, reported by U.S. banks, and changes in short-term claims of U.S. banks on foreigners.

Incidentally, there has been a good deal of analysis of changes in the short-term claims of U.S. banks on foreigners, and I think the reason is that this item has been placed in the capital movements, where there is an inducement to treat it as having an independent pattern of behavior, requiring analysis.

In fact, my colleague, Professor Kenen, has probably studied this question as much as anybody.

No single number, however the deficit is defined, can adequately describe the international position of the United States or provide an absolute measure of the payments problem. The Review Committee has been emphatic in cautioning against exclusive reliance on the figure reported as the deficit in evaluating the U.S. payments position, and I want to emphasize this applies to our definition, too. You cannot just look at a deficit and say, "this is the figure that tells us what the U.S. payments position is, or what the U.S. payments problem is." With the same deficit, the payments problem may be more or less serious, depending on how long it has persisted, whether it results from a deterioration in the trade and service accounts or from a large outflow of private capital, and how the reserve accounts behave, particularly gold and other reserve assets.

I don't think it is the same thing at all to say that for the balance of payments, an increase in banking liabilities to some South American, who is trying to keep some dollars in a safe haven, is the same thing as an outflow of gold.

I think all of these accounts have to be studied separately, and it does not seem reasonable to put together in the same category a disparate conglomeration of private holdings of foreign individuals and companies and of foreign commercial banks, as well as liabilities to the International Monetary Fund, or liabilities to the Bank of France, or a change in our gold holdings.

It has been suggested to the Review Committee by some distinguished people that the U.S. balance of payments should be presented with two or three different definitions of the deficit. They have cited our point that no figure of the deficit can by itself give an adequate understanding of our payments position. As a practical matter, the multiplicity of definitions of the deficit in the balance of payments would be confusing, and it would not obviate the need for careful and detailed analysis.

Generally speaking, the deficit as defined by the Review Committee and the deficit as now defined by the Balance of Payments Division tend to move together. When theirs goes up, ours will generally go up; when ours goes down, theirs will generally go down too. Differences in their movements, when they are significant, usually coincide with changes in monetary conditions in this country and abroad.

The evaluation of the U.S. payments position does not require two or three definitions of the deficit. It does require a thorough analysis of the major constituent accounts in the balance of payments.

By the Review Committee's definition, the payments deficit from 1958 to 1964 averaged $2.6 billion a year compared with an annual average of $3.5 billion as now measured on regular types of transactions.

The Review Committee's definition does not alter the fact that the United States has had a large and persistent deficit, and that it still has a serious payments problem. This is evident in the continued pressure on U.S. reserves. The Review Committee's definition does not diminish the magnitude of the payments problem. Those who have followed the U.S. balance of payments over the years are well aware that the present measure of the deficit overstates the payments problem. That is, the present deficit is not the measure of the amount of improvement in U.S. receipts relative to payments required to reach a long-run equilibrium.

All that the Review Committee has done is to present a more realistic measure of the deficit; that is to say, it has given a measure of the deficit which we believe would result in an appropriate balance of payments in the long run if the deficit averaged zero. The need for policies to eliminate the deficit we have by our definition is no less urgent now than it was before.

There is a problem, even if our recommendations are adopted, of somehow moving without disruption and confusion from the present measure of the deficit to the one that we propose. There are many people who keep themselves informed on current developments, but are not experts in the balance of payments, whose only knowledge of the U.S. payments position comes from quarterly reports of the size of the deficit. They may know the deficit was at an annual rate of $3 billion last quarter, or that it was down by $200 million, annual rate, from the preceding quarter.

These people are well informed people on public affairs, but they do not follow the balance of payments closely. When these people find, because a new definition is being used, that there has been a large decline in the deficit, they could easily confuse that with an improvement in the payments position. And even economists who follow the balance of payments closely will want to know what the deficit would have been on the present definition, as well as on the one recommended by the Review Committee, although that can be easily determined by themselves.

For a time, therefore, the balance of payments could be presented in the new form, that is to say, with the official settlements deficit, along with the data to reconcile this definition of the deficit with the deficit on regular types of transactions. As a matter of fact, the Review Committee has set forth such a reconciliation on page 9 of its report. (See p. 13, this volume.)

Mr. Chairman, there are a few matters in this report that are controversial. That is to be expected in a technical document dealing with an urgent problem of the United States.

There are many other matters on which there is no controversy, but regarding which an evaluation must be made to determine whether it would be worth while implementing certain recommendations on the statistics. The measures we recommend cost money, although in most instances the cost is relatively little. Still there are other statistical changes in other fields that may be more urgent.

We believe that the Government of the United States, very wisely, is turning over to a sub-Cabinet committee the task now of determining which of the many recommendations of the review committee can be implemented, some quickly, some more slowly, and probably, some not at all.

The Review Committee has made many recommendations for improving the quality of the balance of payments statistics, their tabular presentation and the measurement of the deficit. Some of the recommendations of the Review Committee have already been implemented. Others involve costs for personnel and other purposes that must be weighed against the resulting benefits. We welcome the appointment of a sub-Cabinet committee of departmental representatives to consider the various recommendations in the Report.

Most important, it is essential to have a wider public understanding of the U.S. balance of payments. The hearings of the Joint Economic Committee should be invaluable for this purpose. They will bring together the whole range of expert opinion on U.S. balance of payments statistics; and they will focus attention on the need not only for better statistics but on their use with technical competence and commonsense.

And now we are ready for questions

Senator PROXMIRE. Fine. Well, I want to thank you for an expert and informative exposition of this complicated and important subject. I think I will start off questioning Mr. Kenen.

I propose to proceed as follows, and, of course, Congressman Ellsworth will have his turn, as we usually have, after I have 10 minutes. Just to give you an impression of what I would like to do, I want to try first to explore some of the implications of these instant statements, and then I would like to go into the report itself, and some of the questions raised there that may not have been stressed in your statements.

Mr. Kenen, you make a statement at the very beginning in your second sentence which is interesting to this committee, because we are, as you know, responsible for the statistics or every set of statistics by the Federal Government, and perhaps in a jingoistic mood, we have always felt that our American statistics were the best, and we have been told this by some of the people from other countries who have testified.

You seem to say that our balance of payments statistics are better than most countries, and about as good as other U.S. economic statistics. Is there any nation you know of which has better statistics than we have, and which has better balance of payments statistics?

First setting aside this fundamental point, which has been raised and discussed at some length——

Mr. KENEN. I would not care to comment on statistics other than those in the balance of payments.

Senator PROXMIRE. Well, I think that would be appropriate, anyway.

Mr. KENEN. But on the balance of payments statistics of other countries, I can say this: There are some countries, West Germany, perhaps, which provide somewhat more published detail than we do. There are some countries which have more accurate data on certain kinds of transactions. The Germans, for example, have done a very impressive piece of work on an extremely difficult task—the estimation of the very large payments made by immigrant workers into Germany to their families outside Germany—a job which has no exact counterpart in our figures, and which we might not be able to handle, given our present apparatus. Some countries, I would think, have trade and capital statistics as good as ours in some particular respects.

But one thing which has happened to other countries, has not happened to us. As you know, sir, a number of countries relied for years on their exchange control records for data on certain kinds of transactions. This procedure was never satisfactory in respect of capital transactions; the incentive to evade the control was very high and transactions were not reported. But it probably led to a fairly accurate account of service and trade transactions on which we have great difficulty keeping accurate records. Since the relaxation of exchange controls abroad, particularly in Western Europe, that data source is drying up. The number of transactions which are still controlled is diminishing. Other countries, then, are exploring new methods of collecting information, and some of them have been more venturesome than the United States in exploring new methods of data collection. The British, for example, have been overhauling their capital-account statistics with great thoroughness, and in that respect, are perhaps approaching and rivaling our own data.

I don't believe, however, that any foreign country has as complete a set of figures as we already have, taking all accounts together, and I am quite sure that no country that faced the large volume and great variety of transactions that we face would be collecting data as thoroughly and as adequately as we do, even now.

Senator PROXMIRE. You see, the reason that I raise this point is because the thrust of this report with its 20,000 words of recommendations is that we invest more resources and spend a great deal more money in gathering statistics than we have now.

Now other countries, of course, of perhaps less resources than we have, are not as affluent as we are, but if they seem to feel they can get along on the statistics they have, we have to, I think, take a critical look at these recommendations to see if we can justify each recommendation, point by point. We have to determine whether or not, as you say very well, the benefits would exceed the costs.

The costs are very substantial.

Mr. KENEN. Could I comment on that, sir?

Senator PROXMIRE. You have just told me. Let me just interrupt for a minute to say, you have just told us that our statistics are more comprehensive, by far, than in other countries.

Mr. KENEN. I should say this, sir. First, other countries, and I cited the case of Great Britain, are improving their statistics very rapidly, or trying to improve them. They are devoting more of their statistical and budgetary resources to this task than they have been up to now, partly to compensate for the breakdown of their exchange-control data systems, but also because they, too, realize the need for improvement in their statistics.

The British are particularly concerned that their capital accounts are incomplete, and also that their service accounts—which have been extremely important to Britain over many decades—are also incomplete. Because of these efforts, their data are improving relative to ours, and they are devoting more to the task.

In addition, many of these countries rely, perhaps to a greater degree than we know, upon our own statistics, both to check, and very often to supplement, their own. The improvement of our statistics, then, is not only important to us, but also important to the improvement and the maintenance of balance of payments statistics for all countries.

One other point in this connection. With the increased amount of international consultation on balance of payments matters, with the continuing review of national policies in the OECD and other international agencies, the accuracy of these statistics is more important than it ever was before. As other countries improve their accounts, we shall also have to improve ours, in order that we may have a more complete record of what is going on among all countries, particularly among the developed countries.

While it is true, then, that as of this point in time, our figures are still superior in quality to those of most other countries, theirs are improving, while ours are deteriorating. This is what concerns the Review Committee most.

Ours are deteriorating in two ways: First, the benchmarks that serve as the bases for current estimates are getting out of date. Many are already out of date. Estimates, for example, of foreign capital in this country and of U.S. capital abroad are based on decade-old benchmarks—sometimes 15-year-old benchmarks or 25-year-old benchmarks. These cannot really serve us very much longer. They must be revised, if only to maintain the existing quality of the figures. Second, in the last decade, particularly since about 1957–58, the range of American transactions abroad has increased very rapidly. American corporations have begun to engage in a much wider variety of capital transactions. American individuals have become more interested in foreign securities. The range and complexity of international transactions is growing, and is escaping the statistical network we already have. In respect of benchmarks and also the complexity of U.S. transactions we have now to record, we must revise and improve our data collection.

In brief, it is not a question of comparing the merits of our data with the merits of others, but rather the direction in which we are moving. We fear that our figures will deteriorate; we are quite convinced that those of other countries are improving.

Senator PROXMIRE. That is a helpful answer.

Mr. BERNSTEIN. I think we ought to add one point. The very mass of statistics with which our Balance of Payments Division has to deal is frightening. There are entries, many of them net, of $75 billion in the receipts and payments in the U.S. balance of payments. No other country in the world runs much above $25 billion. The number of travelers from this country, the number of individual sales, the number of remittances, these are items which compared with those in any other country are simply massive. That adds to the difficulty of doing the job. And it also adds to the importance of keeping up with it, because our transactions are growing, and they are becoming more complicated all the time.

Senator PROXMIRE. At the same time, it should be easier for other countries to have precise and accurate statistics than for this country.

Mr. BERNSTEIN. That is right.

Senator PROXMIRE. Because, just as you say, their problems are on a much smaller scale.

Mr. BERNSTEIN. Now in some cases, we ought to cooperate with them. For example, we believe the Canadian data on some transactions are much better than ours, and this is going forward. Our Balance of Payments Division, our Treasury people, are working steadily with the Canadians to see how these reciprocal transactions can be checked, one against another.

Senator PROXMIRE. Let me ask you, Dr. Kenen, on that same first page, you discuss the "Errors and omissions" item. Now to most of us, this is pretty shocking. What could be worse than an error, except maybe an omission; or an omission, other than an error? When you put it the way you put it here, it seems very bad, indeed. The words are so bad. I am wondering about what you are telling us, and let me just read these very few sentences here:

The available data on trade, services, and capital transactions identify a bare $250 million of this improvement. Larger changes, favorable to the extent of about $750 million, remain unidentified in net errors and omissions. From 1960 to 1964, the errors and omissions item implied an annual average net payment of over $800 million. The gross errors and omissions in the individual accounts, which are the basis for analyzing the balance of payments, were considerably larger than this net discrepancy.

Now does this error and omission mean that the whole account could be off by $800 million, or does it simply mean that the statistics could not be comprehensive and precise, because there are so many transactions that cannot be reported; that this precise identification cannot be secured, and that the estimate is probably roughly correct, but it is unsatisfactory because it is rough?

Mr. KENEN. First, sir, let me suggest that you will always have errors and omissions in any set of accounts like this, in which you are reporting data from various statistical sources. If, for example, I pay for goods which I have bought abroad, two separate figures will be reported. First, there will be a report on the import of goods, then from a separate source, there will be a report of the payment. And if these are not reported promptly and consistently because of imperfections in the reporting network, there will inevitably be an error in the statistics. All of these transactions involve flows of goods, services, or assets in one direction, then cash flows in the other, and unless the records are absolutely complete, you will always have discrepancies. You have a similar discrepancy, for example, in the national income accounts, where, for example, we record the value of production on one side, and the value of wage payments, profit payments, rents, and other things, on the other side. They won't match perfectly, because the data are from different sources, and sometimes defined slightly differently. In any set of figures which involves the matching of data from many different sources, sometimes defined in very different ways and collected on rather different bases, you will always have a net discrepancy, and that is part of what you have in errors and omissions. But what is more serious about this particular item is, first, that the errors and omissions item in the balance of payments statistics, while small relative to the $75 billion or so of transactions to which Mr. Bernstein referred a moment ago, is large relative to another net number; namely, the recorded surplus or deficit. And when, therefore, one wants to explain changes on the order of a billion dollars or so in the surplus or deficit, and is faced at the same time with a big swing in the errors and omissions item, it is understandably and unfortunately difficult, to determine precisely what has been changing, giving rise to a change in the surplus or deficit.

Senator PROXMIRE. So you know there has been this change, and you know it fairly precisely, but you do not know what has caused it.

Mr. KENEN. Right. And I can show you what some of the implications are.

Senator PROXMIRE. This would not invalidate the $3 billion figure on the present basis?

Mr. BERNSTEIN. With one qualification. The qualification I have in mind is this: by the present definition of the deficit, changes in private holdings of dollars, say, on deposit in banks, are included in the deficit. Now, suppose there is an undisclosed foreign holding of dollars in the United States. Let us say, Monsieur duPont of Paris has a deposit which he put here some years ago, when he was unsure of the franc, and that he gave as his address one of his business associates in New York. Then that deposit was never reported as a foreign dollar holding. When the franc became strong, Monsieur duPont was no longer afraid; he could have withdrawn that money, and it would then go down as an unrecorded capital outflow. No one would have reported it; in which case it would be in the errors and omissions. But, if in the first instance, by the present definition, it had been reported as foreign-owned, its outflow would not have been treated as a capital outflow; it would have been a drop in our foreign liabilities and it would not have increased our deficit.

Mr. BERNSTEIN. It would not have been in the capital transactions. It would have been in the second.

Do you see the difference, Senator?

Senator PROXMIRE. Yes, indeed.

Mr. BERNSTEIN. That is to say, because the present definition includes an account, some accounts, in which undisclosed foreign holdings can be significant, it is quite conceivable that if the errors, if we knew the facts about the errors and omissions, some of them would change the settlement accounts. Do you see what I mean?

And the deficit would be different by the definition we now use. This would even be true by the definition that the Review Committee recommends, but much less true. It is quite conceivable that there would be an acquisition of a dollar asset by a foreign monetary authority that somehow escaped reporting by error. The risk there is very small. The risk that private foreign dollars will escape reporting is very great.

And I would say that is probably one reason, though not a major reason, why the definition proposed by the Review Committee is better suited to the analysis ultimately of the balance of payments.

Senator PROXMIRE. Mr. Ellsworth, my time is up. I will be back.

Mr. ELLSWORTH. Thank you very much, Mr. Chairman.

First of all, I would like to ask, Mr. Chairman, about the schedule of the subcommittee into the future. I assume this will not be the last day of the hearings.

Senator PROXMIRE. No, indeed. The plan is that we have Dr. Bernstein and Dr. Kenen today, and we are going to have other witnesses who have a contrary view, or a supplementary view—a different view, at any rate—later, but it will be substantially later, so they can study the testimony today and consider it at their leisure. We contemplated that we would have our next hearing about a month from now.

Mr. ELLSWORTH. Yes. Thank you very much. Then, Mr. Chairman, I was wondering if it would be possible, I don't know whether I ought to ask you or Mr. Bernstein—or somebody else—to get somewhere into the record the appointing authority or the requesting letter or something in writing that set up this Review Committee, so that we could see the underlying paper authority.

Senator PROXMIRE. Yes, indeed. I think that is an excellent suggestion. We will do that.

Mr. ELLSWORTH. Thank you very much.
(Material referred to follows:)

EXECUTIVE ORDER 11007

PRESCRIBING REGULATIONS FOR THE FORMATION AND USE OF ADVISORY COMMITTEES

Whereas the departments and agencies of the Government frequently make use of advisory committees; and

Whereas the information, advice and recommendations obtained through advisory committees are beneficial to the operations of the Government; and

Whereas it is desirable to impose uniform standards for the departments and agencies of the Government to follow in forming and using advisory committees in order that such committees shall function at all times in consonance with the antitrust and conflict of interest laws:

Now, therefore, by virtue of the authority vested in me by the Constitution and statutes, and as President of the United States, it is hereby ordered as follows:

Section 1. The regulations prescribed in this order for the formation and use of advisory committees shall govern the departments and agencies of the Government to the extent not inconsistent with specific law.

Section 2. As used herein,

(a) The term "advisory committee" means any committee, board, commission, council, conference, panel, task force, or other similar group, or any subcommittee or other subgroup thereof, that is formed by a department or agency of the Government in the interest of obtaining advice or recommendations, or for any other purpose, and that is not composed wholly of officers or employees of the Government. The term also includes any committee, board, commission, council, conference, panel, task force, or other similar group, or any subcommittee or other subgroup thereof, that is not formed by a department or agency, but only during any period when it is being utilized by a department or agency in the same manner as a Government-formed advisory committee.

(b) The term "industry advisory committee" means an advisory committee composed predominantly of members or representatives of a single industry or group of related industries, or of any subdivision of a single industry made on a geographic, service or product basis.

Section 3. No advisory committee shall be formed or utilized by any department or agency unless

(a) specifically authorized by law or

(b) specifically determined as a matter of formal record by the head of the department or agency to be in the public interest in connection with the performance of duties imposed on that department or agency by law.

Section 4. Unless specifically authorized by law to the contrary, no committee shall be utilized for functions not solely advisory, and determinations of action to be taken with respect to matters upon which an advisory committee advises or recommends shall be made solely by officers or employees of the Government.

Section 5. Each industry committee shall be reasonably representative of the group of industries, the single industry, or the geographical, service, or product segment thereof to which it relates, taking into account the size and function of business enterprises in the industry or industries, and their location, affiliation, and competitive status, among other factors. Selection of industry members shall, unless otherwise provided by statute, be limited to individuals actively engaged in operations in the particular industry, industries, or segments concerned, except where the department or agency head deems such limitations would interfere with effective committee operation.

Section 6. The meetings of an advisory committee formed or used by a department or agency shall be subject to the following rules:

(a) No meeting shall be held except at the call of, or with the advance approval of, a full-time salaried officer or employee of the department or agency, and with an agenda formulated or approved by such officer or employee.

(b) All meetings shall be under the chairmanship, or conducted in the presence of, a full-time salaried officer or employee of the Government who shall have the authority and be required to adjourn any meeting whenever he considers adjournment to be in the public interest.

(c) For advisory committees other than industry advisory committees, minutes of each meeting shall be kept which shall, as a minimum, contain a record of persons present, a description of matters discussed and conclusions reached, and copies of all reports received, issued, or approved by the committee. The accuracy of all minutes shall be certified to by a full-time salaried officer or employee of the Government present during the proceedings recorded.

(d) A verbatim transcript shall be kept of all proceedings at each meeting of an industry advisory committee, including the names of all persons present, their affiliation, and the capacity in which they attend: *Provided*, that where the head of a department or agency formally determines that a verbatim transcript would interfere with the proper functioning of such a committee or would be impracticable, and that waiver of the requirement of a verbatim transcript is in the public interest, he may authorize in lieu thereof the keeping of minutes which shall, as a minimum, contain a record of persons present, a description of matters discussed and conclusions reached, and copies of all reports received, issued, or approved by the committee. The accuracy of all minutes shall be certified to by a full-time salaried officer or employee of the Government present during the proceedings recorded.

(e) Industry advisory committees shall not be permitted to receive, compile, or discuss data or reports showing the current or projected commercial operations of identified business enterprises.

(f) In the case of advisory committees other than industry advisory committees, the department or agency head may waive compliance with any requirement contained in subsection (a), (b) or (c) of this section when he formally determines that compliance therewith would interfere with the proper functioning of such a committee or would be impracticable, that adequate provisions are otherwise made to insure that committee operation is subject to Government control and purpose, and that waiver of the requirement is in the public interest.

Section 7. The head of each department or agency sponsoring an advisory committee may prescribe additional regulations, consistent with the provisions and purposes of this order, to govern the formation or use of such committees, or the appointment of members thereof.

Section 8. An advisory committee whose duration is not otherwise fixed by law shall terminate not later than two years from the date of its formation unless the head of the department or agency by which it is utilized determines in writing not more than sixty days prior to the expiration of such two-year period that its continued existence is in the public interest. A like determination by the department or agency head shall be required not more than sixty days prior to the end of each subsequent two-year period to continue the existence of such committee thereafter. For the purpose of this section, the date of formation of an advisory committee in existence on the date of publication of this order shall be deemed to be July 1, 1960, or the actual date of its formation whichever is later.

Section 9. The requirements of this order shall not apply:

(a) to any advisory committee for which Congress by statute has specified the purpose, composition and conduct unless and to the extent such statute authorizes the President to prescribe regulations for the formation or use of such committee;

(b) to any advisory committee composed wholly of representatives of State or local agencies or charitable, religious, educational, civic, social welfare, or other similar nonprofit organizations;

(c) to any local, regional, or national committee whose sole function is the dissemination of information for public agencies, or to any local civic committee whose primary function is that of rendering a public service other than giving advice or making recommendations to the Government.

Section 10. (a) Each department and agency utilizing advisory committees shall publish in its annual report, or otherwise publish annually, a list of such committees, including the names and affiliations of their members, a description of the function of each committee and a statement of the dates of its meetings: *Provided*, that the head of the department or agency concerned may waive this requirement where he determines that such annual publication would be unduly costly or impracticable, but shall make such information available, upon request, to the Congress, the President, or the Attorney General.

(b) A copy of each such report shall be furnished to the Attorney General, and all records and files of advisory committees, including agenda, transcripts or notes of meetings, studies, analyses, reports or other data compliations or working papers, made available to or prepared by or for any such advisory committee, shall be made available, upon request by the Attorney General, to his duly authorized representatives, subject to such security restrictions as may be properly imposed on the materials involved.

Section 11. This order supersedes the directive of February 2, 1959, entitled "Standards and Procedures for the Utilization of Public Advisory Committees by

Government Departments and Agencies," and all provisions of prior Executive orders to the extent they are inconsistent herewith.

JOHN F. KENNEDY.

THE WHITE HOUSE, *February 26, 1962.*

THE WHITE HOUSE, *April 24, 1963.*

The President announced today that the Director of the Bureau of the Budget is appointing a Review Committee for Balance of Payments Statistics. The Committee will comprise eight experts from outside the Government who will study and report on the U.S. balance of payments statistics, with recommendations for their improvement. These statistics are a systematic summary of our economic transactions with the rest of the world, including merchandise trade, international investment, foreign transactions of the Government, tourism, and other transactions involving international payments or transfers of resources, and are essential in measuring the net surplus or deficit in our economic dealings with the rest of the world. The review by the Committee will encompass basic conceptual problems, problems of presentation and analysis, and technical statistical problems.

In an exchange of letters between the President and the Director of the Bureau of the Budget, the President stated:

"You are aware of the urgency which I have attached to progress toward a rational solution of our balance of payments problems of recent years. An indispensable tool in this effort is an adequate body of balance of payments statistics reflecting our transactions with the rest of the world. These statistics must be suitable in concept and detail, accurate, timely, and lucidly presented.

"While recognizing the high regard in which our balance of payments statistics are currently held, I share the view of those who prepare and use them that a review of the concepts, statistical foundations, and mode of presentation of this body of data would serve a most useful purpose. The panel of independent experts whom you have selected should be able to make a significant contribution."

In explaining the purpose of the Committee the Director pointed out that several other important areas of Federal statistics have in the recent past profited significantly from reviews by specially appointed committees of nongovernmental experts—in particular the fields of national accounts, price statistics, and statistics of employment and unemployment. Such committee reviews have served the very useful purposes of providing an independent appraisal of the statistics, highlighting difficulties, clarifying unresolved issues, and pointing directions for improvement.

The new Committee will be advisory to the Bureau of the Budget, pursuant to the Bureau's general responsibilities for statistical coordination and statistical standards within the Federal Government. It will be asked to submit its report about May 1, 1964.

Those who have agreed to serve on the Committee are: Dr. Edward M. Bernstein, research economist, Chairman; Prof. Richard E. Caves of Harvard University; Dr. George Garvy, economic adviser to the Federal Reserve Bank of New York; Dr. Walter E. Hoadley, vice president of the Armstrong Cork Co.; Prof. Harry G. Johnson of the University of Chicago; Prof. Peter B. Kenen of Columbia University; Dr. Roy L. Reierson, senior vice president of the Bankers Trust Co.; and Dr. Charles F. Schwartz, Assistant Director, Western Hemisphere Department, International Monetary Fund. Arrangements have been made for Mr. John E. Reynolds of the staff of the Board of Governors of the Federal Reserve System to serve as Staff Director.

The full text of the letter from the Director to the President and of the President's reply follows:

APRIL 20, 1963.

The PRESIDENT,
The White House,
Washington, D.C.

DEAR MR. PRESIDENT: As you know, the deficits in the U.S. balance of international payments during recent years have given a new importance, both domestically and abroad, to our official balance of payments statistics as a measure of the problem and as a framework of data within which policy analysis can be carried out. As a result a great deal of attention has been and is being given by the balance of payments statisticians and analysts within the Government to a variety of problems relating to the underlying concepts of the data, their statistical adequacy, and their presentation and analysis.

While these efforts by those responsible for the preparation and use of our balance of payments statistics provide a continuous critical review and insure a gradual improvement of the data, I believe that a useful purpose would also be served at this time by a review by experts from outside the Government.

I have accordingly invited a group of outstanding experts to serve as members of a Review Committee for Balance of Payments Statistics and they have agreed to serve. The Chairman is to be Dr. Edward M. Bernstein, research economist. The other members will be Prof. Richard E. Caves of Harvard University; Dr. George Garvy, economic adviser to the Federal Reserve Bank of New York; Dr. Walter E. Hoadley, vice president of the Armstrong Cork Co.; Prof. Harry G. Johnson of the University of Chicago; Prof. Peter B. Kenen of Columbia University; Dr. Charles F. Schwartz, Assistant Director, Western Hemisphere Department, International Monetary Fund; and Dr. Roy L. Reierson, senior vice president of the Bankers Trust Co.

The assignment of the Committee will be to inquire into and to prepare a formal report evaluating the U.S. balance of payments statistics, with recommendations for their improvement. The review is to encompass basic conceptual problems, problems of presentation and analysis, and technical statistical problems of data collection, estimation, and related matters. I shall ask that the report be submitted to me about May 1, 1964.

The decision to appoint this Committee, advisory to the Bureau of the Budget, reflects my general responsibilities for the adequacy of the Federal statistical program, and my special interest in the proper reflection of Federal receipts and expenditures in the balance of payments. I have discussed the possibility of such a committee with several officials who particularly share my concern with this problem, the Secretary of the Treasury, the Chairman of the Council of Economic Advisers, and the Secretary of Commerce, under whom the official figures are prepared. I have found full agreement among these officials that the appointment of a special balance of payments statistical review committee would be a desirable and timely step, and the selection of members has been made with their concurrence.

Let me assure you that our balance of payments statistics are now highly regarded both within and outside the Government. However, as you know, several important areas of Federal statistics have in the recent past profited significantly from reviews by specially appointed committees of nongovernmental experts. Such committee reviews have served the very useful purposes of providing an independent appraisal of the statistics, highlighting difficulties, clarifying unresolved issues, and pointing directions for improvement.

I confidently expect that this technique for evaluation by an independent panel will be fruitful in this area as it has been in others, will help us to move toward significant improvements in the data, and will ultimately make an important contribution toward the continuing development of balance of payments policy.

Respectfully yours,

KERMIT GORDON.

APRIL 23, 1963.

Hon. KERMIT GORDON,
Director, Bureau of the Budget,
Washington, D.C.

DEAR KERMIT: I am pleased to learn of your decision to appoint a Review Committee for Balance of Payments Statistics.

You are aware of the urgency which I have attached to progress toward a rational solution of our balance of payments problems of recent years. An adequate body of balance of payments statistics reflecting our transactions with the rest of the world is an indispensable tool in this effort. While recognizing the high regard in which our balance of payments statistics are currently held, I accept the view of those who prepare and use them that a review of the concepts, statistical foundations, and mode of presentation of this body of data would serve a most useful purpose. The panel of independent experts whom you have selected should be able to make a significant contribution.

Please express my appreciation to those who have agreed to accept this important assignment, extend to them my best wishes for success, and assure them that they will have the fullest support from those in Government to whom they will look for cooperation.

Sincerely,

JOHN F. KENNEDY.

The following is a sample of the letter that was sent to everyone who agreed to serve on the Review Committee.

APRIL 20, 1963.

DEAR ———: I am extremely pleased that you have agreed to serve as a member of the Review Committee for Balance of Payments Statistics. Our personnel office has been requested to obtain from you the information necessary to complete the appointment process.

The establishment of this Committee reflects the heightened interest in the U.S. balance of payments problem and in the adequacy of our balance of payments statistics as a measure of the problem and a framework within which to consider policy alternatives. The Committee will study and render an independent professional judgment regarding these statistics, with reference to underlying concepts, statistical adequacy, and manner of presentation. The terms of reference and the assignment of the Committee are given in more detail in the enclosed project statement, which I am now able to give you in final form.

As you know, Dr. Edward M. Bernstein has agreed to chair the Committee. Others in addition to yourself who have agreed to serve are Prof. Richard E. Caves of Harvard University, Dr. George Garvy of the Federal Reserve Bank of New York, Dr. Walter E. Hoadley of the Armstrong Cork Co., Prof. Harry G. Johnson of the University of Chicago, Dr. Roy L. Reierson of the Bankers Trust Co., and Dr. Charles F. Schwartz of the International Monetary Fund. Arrangements have been made for Mr. John E. Reynolds of the staff of the Board of Governors of the Federal Reserve System to serve as Staff Director.

The Committee will make its headquarters at the Office of Statistical Standards of this Bureau, in the Executive Office Building. Dr. Raymond T. Bowman, Assistant Director for Statistical Standards, will represent the Bureau as host to the Committee. He and his staff will arrange for necessary administrative services and for contacts with other Government agencies.

Please accept my thanks for your willingness to join in this important task.

Sincerely,

KERMIT GORDON, *Director.*

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C.

DETERMINATION PURSUANT TO EXECUTIVE ORDER NO. 11007 OF FEBRUARY 26, 1962

ESTABLISHING THE REVIEW COMMITTEE FOR BALANCE OF PAYMENTS STATISTICS

The Director of the Bureau of the Budget is directed by section 3(a) of the Federal Reports Act of 1942 (5 U.S.C. 139a) to (*a*) investigate the needs of Federal agencies for information from business enterprises; (*b*) to investigate the methods used in obtaining such information; and (*c*) to coordinate the information-collecting services of the agencies, with a view to reducing the cost to the Government and minimizing the burden upon business enterprises. The President, through the Director of the Bureau of the Budget, is authorized and directed by section 103 of the Budget and Accounting Procedures Act of 1950 (31 U.S.C. 18b) to develop programs and to issue regulations and orders for the improved gathering, compiling, analyzing, publishing, and disseminating of statistical information for any purpose by the various agencies of the executive branch of the Government. The Bureau of the Budget is directed by Executive Order 8248, dated September 8, 1939, to plan and promote the improvement, development, and coordination of Federal and other statistical services.

In carrying out these responsibilities, the Director of the Bureau of the Budget seeks the counsel of various persons and organizations competent to appraise the collection and analysis of statistical data by various governmental agencies and to identify gaps and deficiencies in the statistical program. The deficits in the U.S. balance of payments in recent years have given a new importance to our official balance of payments statistics and to a variety of problems faced in compiling, presenting, and interpreting them. These problems are in general of three types: (1) conceptual problems concerning the scope and definition of balance of payments data, and in particular the definition and measurement of deficits (or surpluses); (2) problems concerning the adequacy of the estimates and the accuracy and completeness of the underlying data; and (3) problems concerning the analysis and presentation of balance of payments data. While these problems are being given continuous attention by experts within the Government, it is deemed important that the Bureau of the Budget be able to bring to bear on them also the advice of experts from outside the Government, drawn from the academic and research professions and from banking and business.

The appointment of such an advisory group has been endorsed by Government officials concerned with the improvement of the balance of payments statistics, and in particular has been strongly urged by the Secretary of the Treasury, on whom the President has placed special responsibilities with respect to balance of payments policy and who chairs the Cabinet Committee on the Balance of Payments.

To achieve more effectively the objectives of the Federal Reports Act, the Budget and Accounting Procedures Act of 1950, and Executive Order No. 8248, dated September 8, 1939, and, by contributing to the improvement of the balance of payments statistics, to assist the Secretary of the Treasury in the discharge of his responsibilities regarding balance of payments policy, it is hereby determined that the formation and use of the Review Committee for Balance of Payments Statistics as an advisory committee to the Bureau of the Budget would be in the public interest, and it is hereby established.

It is further determined that the Review Committee for Balance of Payments Statistics shall be continued in existence until June 30, 1964, or until such earlier date as its services may no longer be needed.

1. MEMBERSHIP OF THE COMMITTEE

The Review Committee for Balance of Payments Statistics is deemed to be an advisory committee as defined in section 2(a) of Executive Order No. 11007. In accordance with section 370-6 of the Bureau of the Budget Manual, the members of the Committee shall be appointed as consultants or experts as provided in section 360 of the Manual.

2. MINUTES

Minutes of the meetings of the Committee shall be kept as provided in Bureau of the Budget Manual, section 370-4c, and reports of its operations will be made as provided by the Manual, section 370-9.

KERMIT GORDON, *Director.*

MAY 4, 1963.

Mr. ELLSWORTH. Dr. Kenen, I wonder if you could give me two or three examples of instances where foreign countries rely on and use our statistics in a positive way in developing and shaping their own economic policies.

Mr. KENEN. I think I can give you two instances, sir. In some cases, foreign countries actually use the figures which we publish in their own balance of payments accounts. They, therefore, use the figures we develop to trace the evolution of their own economies. There are such instances, for example, in the service items. I am not quite positive on the details. I would have to check back. But I believe that the Canadians do use some of our statistics on travel in estimating their own position. Then, there are instances in which other countries use our published statistics on capital movements in order to check, and occasionally to correct, the figures they themselves publish in their own tables.

But there is a more important sense in which other countries use our statistics in shaping their policies. The U.S. balance of payments, and its evolution, has a major impact on other countries. The U.S. balance of payments deficit is a matter of great concern, for example, to the European countries. You have heard the argument—one which I would not accept but one which one hears very often—that the large U.S. payments deficit has been a major inflationary force in Western Europe, that Europe has been importing inflation from the

United States. One hears a great many other such arguments—all of which need qualification and some of them refutation, but all of which imply that the size of our deficit, the evolution of our trade and capital movements are of concern to others. So what we publish in our tables, not merely what they publish in theirs, is of importance to them in making monetary policy, in making trade policy, affecting their own economies. Our economy remains, after all, an enormous force in the world economy as a whole. What we do and what is happening to us is taken to have an enormous impact on other countries' prospects, on their own incomes. They will, therefore, watch our figures much more closely than those of any other single country.

Mr. ELLSWORTH. Thank you very much.

Now the next questions that I ask, for as long as my time lasts, will be directed to anybody who wants to answer them.

In view of the shortcomings in availability and adequacy of the data, do we have any reason to suppose that the factual basis of various economic policies of the Government might be wrong as a result of inadequacies and unavailability of data in our balance of payments statistics?

Mr. BERNSTEIN. This is such an important question, I think we should all answer that one.

Mr. ELLSWORTH. Please do.

Mr. BERNSTEIN. I think on the whole, because our balance of payments deficit has been so large and the measures needed to deal with it have been rather strong, it is very unlikely that we have made any wrong policy decisions because of the deficiency in the data. It may be we have—and I think it is almost certain—underestimated the amount of liquid funds put abroad by nonbanking companies.

Mr. ELLSWORTH. Yes.

Mr. BERNSTEIN. The Treasury Department, which has done heroic work in this field, has made nine revisions of the figures on short-term claims of U.S. nonbanking companies. Do not think a revision of the figures is a simple matter of correcting one or two reports. Revising the figures means exploring in depth, with many companies, the ways in which they hold short-term foreign claims which they have never regarded as involving putting money abroad. Now it is almost certain that such holdings are very much underestimated. It may be that when we hear from the companies cooperating on the voluntary program with the Commerce Department and the Treasury, we will discover from the amount of funds they report to us as having been brought home in the form of liquid funds, how different this is from the figure that may have been reported for the same company on its short-term foreign claims in the past. There is no doubt that the deficiencies in the figures make it difficult to decide on what to do. That may be one reason why the voluntary program is superior in some respects to any compulsory program. You leave it to the companies to choose what funds they will bring back, whether some of their liquid investments, or more of their earnings, or whatever else it may be. I think this indicates that the deficiencies of statistics could, under certain conditions, be a factor hampering the taking of policy action.

But I don't believe any mistakes have been made on that account yet. When you have a deficit that has averaged over $2½ billion a year for 7 years, the danger is not that you have taken the wrong steps; the danger is that you have not taken enough steps.

Mr. KENEN. Mr. Ellsworth, may I comment?

Representative ELLSWORTH. I wondered if the other gentlemen wanted to answer, too. Mr. Bernstein said you would.

Mr. KENEN. I should like to comment on just one point, but I would like first to make it clear that I am speaking entirely for myself and not for the Review Committee.

About a year or so ago, I sat at this same table, in a panel with two other gentlemen, and we discussed the importance of interest rates, monetary policy, in influencing capital movements. Two of the people involved in that discussion had worked over these figures with great care and a good deal of frustration. Our difficulty was that the statistics on capital movements, particularly those statistics to which Mr. Bernstein referred, on nonbank U.S. holdings abroad, are incomplete. It is possible today completely to miss the turning points, the critical movements in these very important accounts, and it is therefore very difficult to conduct a detailed economic analysis of the motives for and the consequences of these capital movements.

As a result, we just do not know, not with the precision that we should like, how important interest rates are in affecting international capital movements, whether short-term or long-term. I can't say, as a consequence, that our monetary policies have been right or wrong. I am saying, however, that on this particular score we really do not know what our monetary policies should be.

I am again working over these same figures in connection with my research. There has been some improvement in the precision and quality of the data over the last couple of years. I am getting somewhat better statistical results in my investigation, but it is extremely difficult to evaluate policy, simply because we don't have the data with which to conduct an incisive economic analysis of the way in which companies, banks and others respond to changes in monetary policy.

Representative ELLSWORTH. Well, there are some people around here who have no difficulty at all in determining whether or not our interest rates are right or wrong, but you mean so far as balance of payments is concerned.

Mr. KENEN. I mean solely in that respect; yes.

Representative ELLSWORTH. Mr. Reynolds?

Mr. REYNOLDS. I don't think I have anything else to add to that.

Representative ELLSWORTH. Thank you very much.

Mr. Chairman, my time is up.

Senator PROXMIRE. If you want to follow up that particular question——

Representative ELLSWORTH. No. I was moving to another question. Thank you.

Senator PROXMIRE. Let me follow up that question a little bit.

Dr. Bernstein, I am going to challenge you and Dr. Kenen and Dr. Reynolds. Here we have a very distinguished panel, very able men; you can't point to one single policy, not one, that would be altered or would have been altered if we had more comprehensive statistics or if we had had a different basis for measuring the deficit than we have now. You haven't pointed to one that might be challenged, or one that might be modified a little bit. You say, you might have had a different situation.

Mr. BERNSTEIN. Senator, I should point out that in a gentle way I was trying to say the following: That the balance of payments deficits, however measured, or even with the most generous measurement, were so large, for so long, that the general comment ought to be not that we have taken measures that weren't necessary, the wrong measures, but that not enough was done to deal with the balance of payments problem.

Senator PROXMIRE. Well—if I could interrupt at this point—your recommended change, however, would have given us a gentler and lighter warning than this one. At least, the deficit would have been more modest? It would have been less——

Mr. BERNSTEIN. Senator, the problem, as I have tried to explain, is really the same, because if you have a thermometer which reads minus 2° C., for freezing water, instead of zero, why, obviously, the degree of absolute cold the thermometer shows is going to be off by 2°.

There is no difference in the measurement of the magnitude of the payments problem between our definition and the Commerce Department definition. That is because we believe that in the long run, a zero deficit by our definition would involve no payments problem for the United States.

But I think that by the definition of the Balance of Payments Division, some deficit between $500 million, say, and a billion dollars, might be regarded as an average over a long run that could be sustained by the economy indefinitely, without any adverse consequences.

So, we haven't changed the magnitude of the problem. People who understand the meaning of the Balance of Payments Division's deficit have the same magnitudes in mind as we. It is quite true, I think, that the general public has been led to believe that if the deficit is $3 billion, that is the amount of improvement in receipts relative to payments which is needed, on an average over a long period, to get rid of the problem. I think that may be what the general public believes.

But the Review Committee has not reduced the magnitude of the problem. We have just changed the measure of the deficit by starting from zero as a proper deficit instead of starting from $500 million to $1 billion as a proper deficit. In the past 7 years, our measure of the deficit averaged $2.6 billion. Senator, that is an enormous deficit for a country to sustain for 7 years. That is a very large deficit over a very long time, and a big part of it has been met by gold. True, not much gold went out last year; but from 1958 to 1960 the gold outflow was very large, and again a very large amount is going out this year.

I don't think I would be prepared to argue that we have taken strong measures to improve the balance of payments in any place where weaker ones would have been desirable. On the other hand, I am prepared to argue that on the whole, we have neglected taking measures earlier, for example, measures along the lines we are taking now, which would——

Senator PROXMIRE. I think that is a matter of—I don't mean to interrupt—but I do think that that is a matter perhaps of policy, but not necessarily a matter of statistics, in view of the fact that statistics are more alarming under the old system than they are under the new one.

You see, you are recommending two things, generally. No. 1, that we change the method of measuring the deficit. I have great sympathy with that. I think you have made an excellent and very logical and quite persuasive case.

No. 2, you have recommended a series of other changes with more comprehensive, more accurate, more detailed statistics, all of which will take more money.

Now, if we take No. 1, it always means some upsetting and some adjusting, and some confusion, and so forth, because you do change it, and, psychologically, the time might not be appropriate, in view of the fact that we still have an adverse balance of payments.

Some people will say we are juggling the figures, just to show we aren't doing so badly. If you show two figures, people say you can't make up your mind which is right, and that adds to the confusion.

Furthermore, whenever you ask the Congress of the United States, it seems to me, to spend a substantial amount of money, you ought to be able to show that there is some likely consequence and improved policy that is going to flow from it. And I am just wondering if you can give us a little more ammunition on this score, because we are going to be up against some administration people who are going to give us a tough fight on your position, in about a month or so.

Mr. Kenen?

Mr. Kenen. Senator, I would first of all like to take issue with both chairmen, yourself, and the Chairman of our Review Committee, for just a moment. I would like to suggest that, in one particular instance, our policies, and also those of other countries, may have been influenced by the concept we are now using.

I have in mind the very sharp difference between these two sets of figures—the present definition of the deficit and the one we propose—in 1964, and particularly in the last quarter of 1964. I don't have the quarterly figures in front of me. But there was a $1.4 billion increase of foreign private holdings, mainly foreign bank holdings of dollars here, in 1964 as a whole, which made the 1964 deficit on the present definition look very large indeed. On our definition of deficit, there was a rather sharp decline in the deficit between 1963 and 1964. In fact, there has been a sharp decline, as you can see from our figures, in each of the last 2 years.

Senator Proxmire. So that, in that quarter, the measurement that you are suggesting showed an improvement. And in that quarter, the old measurement showed a deterioration. And your impression is that Senators and Congressmen and others who are very important in determining policy, of course, make decisions and their votes on the floor may well have been deceived by a figure that didn't reflect accurately what the situation really is.

Mr. Kenen. I would not say, sir, that this was true only at this end of Pennsylvania Avenue; it may have been true at the other end of Pennsylvania Avenue, too. In any case, there was a substantial improvement in the position last year. While it is still serious, it was not cause for all of the excitement, talk, and rumor that was generated at the end of last year and that preceded the steps which the administration finally took.

I should suggest, also, that some of our friends in Europe would have been much less alarmed and might have put much less pressure on us than they actually did, if they had seen the evolution of our deficit shown in the Review Committee's summary table. It went from $3.3 billion in 1962 to $2.3 billion in 1963, to $1.5 billion in 1964.

In brief, while the problem is still serious, there has been a substantial improvement, revealed by these figures but concealed by the present figures—an improvement which suggests that we are not under, or ought not to be under, such immediate and heavy pressure to make the remainder of the adjustment.

And while I don't know that our policy would have been different if the Review Committee's figures had been the ones people were looking at, I suspect there would have been a very different attitude, and much less panic in many places, particularly in the banking community, where there was a great deal of discussion. It was thought that our situation was deteriorating very badly; that the situation was getting much worse.

Senator PROXMIRE. Does this imply that the President's action in February may have been a little precipitous or extreme?

Mr. KENEN. I deliberately avoided saying that, because I am entirely in sympathy with that action. But I don't think that it was right to float quite so many trial balloons; I don't think it was necessary to offer reassurance by demonstrating that action was forthcoming. I suspect, moreover, that there was a good deal of pressure coming from outside the Government to do something in a hurry, because of this apparent deterioration in the last months of the year.

I do not say that the President's program is wrong; it is a good program. But the way things were done, and the atmosphere in which they were done, in the last months of last year and the early months of this year might have been different and better if we had been seeing an improvement rather than an apparent deterioration.

Senator PROXMIRE. Can we quantify this at all? Well, that is on a different subject.

I was going to ask you to give me—and maybe you can do this a little later on—your statement of how much it would cost to make these recommendations that you suggest a reality, increasing the staffing, increasing gathering information. But let me come back to that.

Mr. BERNSTEIN. May I add a point to this question?

Senator PROXMIRE. Yes, indeed.

Mr. BERNSTEIN. I think this question you have put, Senator Proxmire, is very, very important.

The function of statistics is to provide insight into policymaking. It is interesting to have statistics for their own sake, but how much you spend on them really depends on how much they are going to contribute to wiser policy.

I am glad that Professor Kennen has a different approach to this question from mine.

I would like to empahsize something else about balance of payments statistics, and especially the deficit, and the natural reaction, and the proper reaction, of the monetary authorities in dealing with payments problems. I have said once before that the deficit doesn't determine how serious your balance of payments problem is, and I mentioned many things that must be considered. Now I would like to emphasize one of the things I mentioned before.

It would be very foolish of our Government to institute, so to speak, a major change in policy, and that's what this voluntary program is, solely because our deficit increased with all of the increase going into private holdings of dollars. On the other hand, it would be unwise of our Government not to take major steps to eliminate the deficit so long as it remains high, even though the balance of payments is improving.

However, if the gold outflow becomes very large, the problem becomes much more urgent. It has always been true, and it remains true, that it is not merely the size of the deficit, the sum of the constituent accounts in the settlement items that counts, but also the composition of the settlement items.

Now, this Government had no choice, in my opinion, but to respond promptly, and strongly, to the big gold outflow. And, I might add that many of us had expected that the gold outflow would, in fact, become larger when the balance of payments began to improve. You will be astonished at how countries then say, "Well, now we can certainly take this gold we have been waiting for."

Do you see what I mean?

Senator PROXMIRE. This is a startling and interesting observation. You feel that as we move into a position of balance, and so forth, that other countries are likely to——

Mr. BERNSTEIN. I said this 2 years ago, Senator.

Senator PROXMIRE. I missed it.

Mr. BERNSTEIN. Well, I didn't say it very publicly, but I said it to people who were listening, including some who are at this table, that when our balance of payments gets to be better, some countries which are reluctant accumulators of dollars in their official holdings are going to say, "Well, now, we can take more gold."

Senator PROXMIRE. Of course, the implication of this is we had better not improve our balance of payments.

Mr. BERNSTEIN. I don't think so, Senator.

Senator PROXMIRE. No. I was being facetious.

Mr. BERNSTEIN. But I think there is a point there. I think in a facetious way, you have made an important point. It means this: That when you have begun to improve your balance of payments, after so many years, it is essential to go very quickly in wiping out the deficit entirely. And that is what is going to happen, if this program is successful.

Even then, there may be residual conversions of dollars into gold; but it is not large holdings of dollars today by, say, France and Germany, that are the threat to our gold reserves. All holdings are, after all, limited. They aren't that excessive.

It is the accumulation from current surpluses of theirs that is the threat to our gold reserve and so we do have to move quickly to eliminate the payments deficit completely.

Senator PROXMIRE. Congressman Ellsworth, I have exceeded my time.

Representative ELLSWORTH. Thank you.

Well, in view of what you have just said, I am all the more alarmed than I was 2 or 3 days ago, when I saw an item in the Journal of Commerce to the effect that our balance on trade was going down this year, and that the net effect of it might be—setting that off against the improvement from these voluntary programs—that we wouldn't have the very substantial improvement at all in our overall deficit for the year. Would you like to comment on that?

It is not a question, but——

Mr. BERNSTEIN. Well, I would be glad to make a comment, but I think that, in fact, when you call on the Balance of Payments

Division, you will have some experts who are working all the time on what these prospective figures are, and while their view may be different from mine, not only on the measure of the deficit, but what is going to happen to the deficit, I think theirs will be a better informed view than mine. I don't believe—I don't think that the view you quoted is correct.

Representative ELLSWORTH. Thank you.

Now, Dr. Kenen, I wonder if you would pinpoint a little bit more than you did just exactly where the statistics, particularly in the last quarter of last year, were off, and what policies might have been taken as a result of mistaken impressions due to errors in the statistics?

Mr. KENEN. Well, in the particular case of fourth quarter 1964, it was not so much inaccurate statistics, but rather that the concept of deficit we were using gave what I would regard as a misleading picture.

Representative ELLSWORTH. Okay.

Mr. KENEN. Again, I have not studied the fourth quarter figures with as much care as I would like. I was busy reading proof of this Review Committee report at the time that I would normally be looking at those figures. But one of the things that happened to us in the fourth quarter of 1964, throughout 1964, in fact, was this: As you know, a great many American corporations have been placing funds on deposit with foreign banks, particularly Canadian banks. We don't have accurate figures on these placements. In fact, this is one of the areas where the figures are most seriously deficient. A very crude check, which consists of comparing the published Canadian figures with our own figures, suggests that we are missing a very large part of this very important cash placement with Canadian banks.

Now, what happens, in turn, is that the Canadian banks place some of this money back in the New York money market at a somewhat higher rate of interest, particularly in loans to brokerage firms—street loans, as they are called. They are not compelled to do so; no one requires that they do this. They do this because it is profitable, and also because some part of their U.S. dollar obligations to American business should be, in their view, offset by dollar claims held against the United States.

What happens under present accounting methods, however, is that the funds which go out from the United States to Canadian banks appear, if I may use the term, above the line, that is, as transactions generating a balance of payments deficit. They are treated as a capital outflow from the United States. Some of them appear explicitly in the figures; some appear in the errors and omissions item, because these particular figures are notoriously incomplete. But because, under our present definition, we regard an increase of our liabilities to foreign banks as a measure of deficit, the corresponding voluntary capital inflow into the United States from Canadian banks is shown as swelling the deficit, rather than a capital inflow from foreigners. And, while I don't have a detailed breakdown of the figures at hand, I suspect that a part of the $1.4 billion increase of liabilities to foreign commercial banks, in 1964, which is currently shown as part of the deficit and, therefore, a danger signal, was, in fact, this offsetting by Canadian and other banks of dollar placements by U.S. corporations abroad.

Now, what will happen in reverse this year, 1965? As American corporations pull some part of their money out of Canada in response to the voluntary program, so, too, will the Canadian banks pull some money out of New York. I have already heard from friends in New York that there is some pressure in the money market, indicating that these Canadian funds are being pulled out; there is some rise in money rates, suggesting that the Canadian banks are pulling money out. What this suggests, then, is that the abnormally large deficit, using the present concept, will be reversed this current year, as the counterpart of the President's program.

But, all in all, these movements are—or should be—a matter of very little concern, not a cause for urgent policy action by the United States. They involve ordinary commercial transactions that net out above the line; they should not serve as a danger signal to us.

It was a rather long, involved answer; it is a rather complicated example. But I think it shows how, particularly in the short run as money market developments occur, the inclusion as a financing item of liabilities to foreign commercial banks can distort the figures rather badly, and cause excessive concern.

Again I don't want to say that we took the wrong step this spring. I don't think we did. Some action was required, and it is important that we get the deficit down even further, very rapidly. I agree with Mr. Bernstein. But the rumors of impending catastrophe that developed outside, the Government and in Western Europe where they generated a good deal of support in favor of General de Gaulle's position—these rumors were partly the consequence of a serious distortion in our figures.

Mr. Ellsworth. Thank you very much. Do either of the other gentlemen want to comment further?

Mr. Bernstein. I think what Professor Kenen has said about the behavior of the Canadians is equally true of some other countries. Actually, the Canadians and the Swiss are the only countries that appear to put money in Wall Street for brokers' loans. But in truth, when funds move to other places from the United States, there may be a tendency for some of it to be offset here. I don't think that trying to isolate each transaction and seeing which can be offset is the right way to deal with it.

I think the right way to deal with it is to take our definition of the deficit. I think our balance of payments did show a stronger position last year. And I think it was generally believed to be stronger by everybody, until the figures showing a larger deficit came out with so much gloomy comment.

On the other hand, I don't think the Treasury responded just to the change in the balance of payments deficit, whether as defined by the Balance of Payments Division or as defined by the Review Committee. It really had to respond to the pressure of this sudden outflow of gold. It had to protect our reserves, and the way to do that was to show that we are going to eliminate the deficit completely this year. And I think it will be successful.

Incidentally, the improvement by the present definition will be greater than by ours.

Mr. Ellsworth. Thank you.

Now in my next question, when I quote, I am quoting from the Report, and the question is this: If it is true that "no single number can adequately describe the international payments position of this country at any time," then why should the summary and detailed balance of payments tables identify any particular balance as "the deficit"?

Mr. BERNSTEIN. John, would you like to answer that question; or do you want me to answer it? I think it is time for you to answer it.

Mr. REYNOLDS. No; I would be willing to.

The Review Committee debated at some length this very question, sir, and asked itself whether we had to publish any figure of overall deficit at all. It would have been, in a way, easier not to. We could have skirted a lot of controversy. But it was the Committee's conclusion, after discussing the matter, and particularly discussing it with users of the statistics, that people who have not got time to follow the balance of payments in detail really have to have some way of summarizing it to themselves, and that if the Government itself does not provide any measure of deficit in its balance of payments tables, then people will cook up their own, and we will become dependent upon newspaper headline writers and observers who perhaps have not had time to study it carefully to define the deficit for us. It seems that the U.S. Government ought to try to present the best simple summary it could, even though it should warn everybody that if they want a full picture, they have got to go into it in much more detail.

Mr. ELLSWORTH. Thank you.

Mr. BERNSTEIN. May I add another point to that?

Mr. ELLSWORTH. Certainly.

Mr. BERNSTEIN. It is this: If you set up the balance of payments in logical order, there is a gradation in types of transactions. You will find that when you get down to one or two final categories, someone is bound to say "Well, everything in this category, for example, the category reserve transactions, is the measure of the deficit." Somebody will draw the line there. You could set up the balance of payments in such a way that right above the reserve category are changes in the liabilities of the U.S. banks to foreign commercial banks, and someone else may draw the line there, so that both changes in liabilities to foreign banks and changes in the reserve accounts would be regarded as the measure of the deficit.

At some point in the table, there is a logical place where the intelligent reader will draw a line for measuring the deficit and that is probably the suggestion you have in mind. Set it up in a logical way, and then each person can draw the line where he wishes. Furthermore, he may draw the line differently at different times for different purposes. That is an alternative, a very reasonable alternative, that we debated.

The other alternative was to draw several lines and to show several surpluses or deficits. That is an alternative suggested to us from very persuasive and important people. They wanted the present definition on regular types of transactions and our definition. The two together; and maybe even a third. We concluded that such a multiplicity of deficits would be confusing and we decided on one deficit.

I believe that in the end, the best thing we can say for our definition is that it reflects the workings of the international monetary system; it represents in any given period the intervention the monetary authorities had to undertake to keep the international transactions and the exchange market in order.

Furthermore, if that balance of payments deficit, as we define it, averages out at zero over a long period of time, the balance of payments of the United States will be in a good position in the sense there will be no serious problems for our monetary authorities created by the balance of payments deficit.

On the other hand, our view is that if the balance of payments deficit as now defined were zero over a long time, we would have a deflation in the world's holdings of dollars, not necessarily of the monetary authorities, but of dollars held by banks and businessmen that they need for working balances and liquid investments.

Or, conversely, with a deficit of between $500 million and $1 billion on an average, over a long period of years, as the deficit is now defined, we would have no balance of payments problems, no pressure on our monetary authorities, excluding, of course, short-period movements in the reserve accounts.

Now we felt we had to have a definition, and we thought that ours was a reasonable one, because it set a zero deficit as the proper balance of payments deficit in the long run.

Mr. ELLSWORTH. Thank you very much.

Thank you, Mr. Chairman.

Senator PROXMIRE. Senator Douglas.

Senator DOUGLAS. Well, I must apologize for not having had time to prepare the questions on this subject. But if the witness will bear with me, I would like to see if I understand some of your points.

Do I take it that the essential feature of the recommendation of your committee is that we exclude as a deficit item in the balance of payments investments by American companies or individuals abroad? Am I wrong on that?

Mr. BERNSTEIN. Yes, sir, I am sorry to say——

Senator DOUGLAS. What is the essential feature that you propose?

Mr. BERNSTEIN. The essential feature is this, Senator Douglas: that when foreigners, private foreigners, individuals and companies, acquire dollar balances in New York, or Chicago, or California, or when they acquire other liquid investments, we should regard such funds as a capital inflow into the United States, and not as a settlement item which is part of the present measure of the deficit.

Perhaps I have to go back to what the present definition is. The present definition of the deficit is that it can be measured by the decrease in the reserve assets of the United States, and in the increase in a broad category of liabilities called liquid liabilities. These liquid liabilities range from liabilities to foreign monetary authorities, say the Bank of France, to liabilities to foreign commercial banks, to liabilities to foreign individuals and companies, and also, a group of liabilities to international monetary institutions like the World Bank and the Inter-American Development Bank.

Well, what we have said, Senator, is that this is not an appropriate measure of the deficit. We would like to exclude from this definition of the deficit changes in the cash balances of the World Bank, because we believe that most of these changes occur from their floating a security issue and then investing the money here until they have loans to make.

We would put them on a loan disbursement basis.

Second, we would exclude from the measure of the deficit changes in private holdings of dollars. If foreign companies want to put dollars in this country, as working balances or liquid investments, we think they do this because it is good business for them, and we would treat it as a capital inflow, just as when our companies or banks put capital abroad, it is because it is good business for them, and we treat it as a capital outflow.

These would be the principal changes we would make, Senator.

Senator DOUGLAS. I think I would agree with you on the first point. Let me ask you about the second, though. While it is true that only foreign governments, central banks, and, under certain circumstances, international institutions can demand gold for their holdings in dollars, is it not easy for individuals, private banks, and businesses to sell their dollar claims to their central banks, so that these potential claims can quickly become actual claims?

Mr. BERNSTEIN. Yes, Senator, it is quite true that there are assets held by foreigners that can come into the hands of the monetary authorities, and then become liabilities of the kind we would put in the deficit. These may be potential reserve liabilities.

Incidentally, there are assets held by American companies and American banks which could come into the hands of the European monetary authorities just as easily—in fact, more easily, because when our banks decide to make loans abroad, or our companies decide to put money on the Euro-dollar market, these funds get into the hands of foreign monetary authorities. I would say these liquid holdings are also potential receipts of the foreign monetary authorities, but I would treat them as reserve liabilities only when they become actual receipts of the monetary authorities.

Senator DOUGLAS. Now, what would you do with the holdings of the private foreign banks?

Mr. BERNSTEIN. Commercial banks?

Senator DOUGLAS. Yes; holdings in dollars of private foreign banks, which they have not yet sold to their central monetary authorities?

Mr. BERNSTEIN. We would regard an increase in such holdings as capital inflow into the United States. There are a number of reasons for this. Some of the funds that they hold in this country, Senator, are held because they have liabilities to banks in this country.

They are not, so to speak, available for sale to their monetary authorities. Some banks hold funds here because they have arrangements with American banks where they keep working balances here, and our banks keep working balances with them.

Senator DOUGLAS. You would exclude them, then?

Mr. BERNSTEIN. I would exclude them, and put them into capital movements.

Senator DOUGLAS. So that the category of short-time claims against the United States, which you would include in the measurement of the deficit, would be the holdings of foreign central banks, monetary authorities, and governments. Is that right?

Mr. BERNSTEIN. That is right. And, of course, we would include the International Monetary Fund in that category.

Senator DOUGLAS. Yes.

Mr. BERNSTEIN. Yes, sir.

Senator DOUGLAS. Well, as I understand it, the foreign monetary authorities have about $12 billion of claims against the dollar?

Mr. BERNSTEIN. I think maybe more.

Senator DOUGLAS. And there is about $10 billion more held privately by banks, businesses, and individuals?

Mr. BERNSTEIN. Here is the Treasury bulletin, if you want to look, Peter.

Senator DOUGLAS. These are, as I think I remember, approximate figures.

Mr. BERNSTEIN. Senator, there are other liabilities to foreign official holders in addition to the banking liabilities, and by the definition which the Review Committee would use, we would include in reserve liabilities certain types of special bonds issued by the Treasury to foreign monetary authorities. They may not all be included in the banking data.

Senator DOUGLAS. And then there are $5 or $6 billion in holdings by the International Monetary Fund?

Mr. BERNSTEIN. We treat the IMF in a different way, Senator, in this sense: They do hold some of our dollars, but we also have claims against them. We take the net of these claims, so to speak, and put them down as a reserve asset. At present, they are a reserve asset to the extent of around $700 million. As we draw from them, and we may draw from them, we would show that as a decline in a reserve asset. If we draw more than the $700 million, we would become indebted to the IMF, and we would show that, generally, as an increase in our reserve liabilities to the fund. So we would treat the fund on a separate line, sometimes on two lines, one for a change in our net asset position, one for a change in our net liability position.

Senator DOUGLAS. Now, do I understand correctly that, if we use the official settlements figures, we do not have a deficit in the balance of payments?

Mr. BERNSTEIN. No, sir. Senator——

Senator DOUGLAS. How much of a deficit do we have?

Mr. BERNSTEIN. On an average, over the period from 1958 to 1964, the deficit by our definition would have been $2.6 billion.

Senator DOUGLAS. Total?

Mr. BERNSTEIN. No, per annum. Average annual deficit. By the definition used by the Balance of Payments Division, it would be $3½ billion, by their definition on ordinary types of transactions.

Senator DOUGLAS. So it roughly makes a difference of $1 billion a year?

Mr. BERNSTEIN. $900 million on an average, though it is higher in part because of the unusual increase of private holdings last year; 1964 was a very special year, Senator, particularly the increase in dollar holdings of foreign commercial banks. Page 9 of the Review Committee report has a reconciliation of our definition of the deficit and one deficit that is now used. The table on page 9 shows which accounts are the ones that make up the difference in the two measures of the deficit.

In this period, Senator, foreign official capital, other than the monetary institutions, account for around $350 million a year. In my opinion, there simply isn't any reasonable argument for including that in the measurement of the deficit.

I would say that it is the first two lines that you are concerned with. That is changes in the claims of foreign commercial banks and in other liquid foreign private claims.

Now, Senator, I think the argument that these dollars can get into the hands of the monetary authorities is certainly hypothetically true. It simply does not conform to the behavior of the last 20 years.

As I have said in my statement, from 1945 to 1964, there were only 2 years in which private holdings of dollars declined. This includes periods of the greatest stress for these foreign countries, when they were desperate for dollars, when they had complete exchange control. It includes periods when there were great doubts about the strength of the dollar. Nevertheless, except in 1948 and 1960 when private holdings of dollars went down by $26 and $65 million, they actually rose in every single year.

By contrast, Senator, there are other holdings of assets in the United States by foreigners which are much more volatile, and when foreigners, for example, sell their common stocks, the dollars get into the hands of their monetary authorities, unless they are acquired, perhaps, by banks or some other private holder. Well, net sales of U.S. stocks by foreigners were $350 million in 1964. There are a half a dozen years in which there were net sales of such securities, so if we are looking for assets which are volatile, which may be sold by foreigners, and which will provide dollar proceeds that get into the hands of the monetary authorities, here are foreign assets that are much more likely to result in dollars getting into the hands of the monetary authorities. Nevertheless, such transactions are put in the capital account of the balance of payments.

And then as I said, Senator, the most important dollars that get into the hands of monetary authorities are not the dollars they get from the calling in, so to speak, of the private holdings of dollars. This was done by France when it was in desperate need of foreign exchange. It was called ratissage—raking in the money.

Now, this isn't the sort of thing that is of consequence in making a drain on our reserves—on our gold. Not the dollars that foreign monetary authorities draw back from their private individuals, companies, and banks. It is the outflow of dollars from American companies and American banks. These dollars get into the hands of the monetary authorities, too. They are the biggest potential drain, and it has in practice been the biggest drain, but I know of nobody who suggests that we ought, for that reason, to regard the liquidity of the American corporations and American banks as part of the balance of payments deficit. We ought to wait until what is a potential reserve liability becomes real, if it ever does. When the dollars get into the hands of the monetary authorities, that is the time to measure it as part of the balance of payments deficit.

Senator DOUGLAS. My time is up.

Senator PROXMIRE. Could I—I think it would help a great deal to clarify the situation as far as your symmetry argument is concerned, if you could give us some examples.

Mr. BERNSTEIN. Gladly.

Senator PROXMIRE. Could you show us, if we use our system of measurement, the one that is now being used by the Department of Commerce in measuring the deficit, what effect this would have, for example, in Germany, France, in Great Britain, and perhaps in Switzerland, over the past 2 or 3 years?

Now, first, let me ask a general question: Which of these countries which in—as I get it—have been in surplus, would, by our measurement, have been in deficit in this period?

Mr. BERNSTEIN. Senator——

Senator PROXMIRE. I am asking the specific question for the record, so that you can put that in at your leisure.

Mr. BERNSTEIN. Well, we can give you an answer now.

Senator PROXMIRE. All right; fine.

Mr. BERNSTEIN. I think we have some experts here who have studied in depth the balance of payments of other countries, especially Professor Kenen on the German capital figures. Americans keep funds in German banks and the German money markets. I don't think that the annual flow to that one country has been on such a scale as to make the German surplus a deficit if it had been counted as a liability by the Germans as we do. What difference would it have made, Peter? Do you recall?

Mr. KENEN. I think there may be one year in which, had the Germans used the statistics we now use, counting all of their liabilities to foreigners as settlement items, they might have shown a deficit when, otherwise, they showed a surplus. But I could not be sure without checking on that figure.

Mr. BERNSTEIN. The British case is a better case, then.

Mr. KENEN. The British case would be a better example, in several instances. They would have shown substantially larger deficits in two or three instances.

Mr. BERNSTEIN. You see, the British offset the private liabilities and the private claims, so to speak. Of course, they have an exchange control reason for this. But suppose that they had followed the practice of counting short-term banking liabilities as a part of the measure of the deficit, but not offsetting this by short-term banking claims on foreigners. The British would have shown a worse balance of payments by $500 million or more in many years.

The case of Canada is so striking as to make it impossible to use the Balance of Payments Division definition of the deficit. Canada has had an enormous inflow of U.S. funds for liquid investment. Most of these funds are then reinvested in the United States and part are placed in Euro-dollar deposits in London. In some years, the Canadian deficit would have been from $500 million to a billion dollars if short-term liquid liabilities were included in the measure of the deficit.

Senator PROXMIRE. You told us, however, earlier, that if we followed the policy—if all other countries followed the definition we now follow—that there would be a general tendency to have an aggregate deficit that would be substantial, in many countries.

Mr. BERNSTEIN. I don't change that, Senator.

Senator PROXMIRE. And if we follow the proposal that you make, the differences would cancel out, and the balances would amount to zero.

Mr. BERNSTEIN. Or nearly zero.

Senator PROXMIRE. Nearly zero. So it would be pretty symmetrical?

Mr. BERNSTEIN. Shall I explain why that is so? That remains true.

Senator PROXMIRE. I wish you would explain why it is so, and then if you cannot document it at the present time——

Mr. BERNSTEIN. We can document it.

Senator PROXMIRE. Fine, because I think it is so important to be able to dramatize this situation by pointing out that there are countries which now seem to be in substantial surplus, and actually are not, on the basis of the system that we are using here.

Mr. BERNSTEIN. Senator, all other countries together, by our definition, will be in surplus by the amount of our deficit. Do you see what I mean?

Senator PROXMIRE. I understand, but there must be some countries that are not.

Mr. BERNSTEIN. We will have to find the instances in some countries. You see, using the Commerce Department definition, the deficit has been on an average $3½ billion. All other countries are relatively small. The large countries have had surpluses even by our definition—to find one that would have a deficit may not be easy, except for the United Kingdom.

Now, if I may explain why the total of all surpluses and deficits would be zero, by our definition. A decrease in our gold holdings would be part of our deficit; but, of course, if there is a decrease in our gold holdings, there is an increase in the gold holdings of some other monetary authority. We have sold it to them.

So that would be matched by another country.

If there is an increase in our holdings of foreign exchange reserves by the Federal Reserve or the Treasury, that would be a liability in another country, so it would be matched. If there is an increase in our liabilities to foreign monetary institutions, there would be an increase in their official holdings of dollar assets, and that would be matched. And this is all that would normally count.

Now, the way gold is treated in the balance of payments could result in small discrepancies. Newly mined gold is treated as an export. Industrial consumption of gold is treated as if it were an imputed import. So it is the net change from newly mined gold, minus what goes into hoards, minus industrial uses, and nowadays we have to add net sales from the Soviet Union, which goes into the balance of payments, and this results in an aggregate surplus equivalent to this addition.

Now, suppose we used the present definition of our Balance of Payments Division. Then American companies acquire deposits, claims against Canadian banks, even though the money is kept in New York. The Canadians would then have to count that as part of their deficit. We would not count that as part of our surplus. American companies, and American banks, too, put dollars in the Eurodollar market in London which are then lent out to borrowers. The British, who nowadays simply regard the foreign claims they have as offsetting their liabilities, would have a reserve liability for the influx of funds without offsetting claims for the loans. And this would increase their deficit.

So, you would have each country counting the liabilities it has to private foreigners as settlement items, but not counting as part of the settlement items the claims on foreigners of its private residents, including its banks.

When you sum this up, the aggregate surplus or deficit would be the following. It would be zero for the reserve accounts, minus the increase in all private claims in foreign countries, plus the net change in monetary gold, because that would be in there, too.

Suppose that the average increment of gold in the monetary stocks of all countries is around $500 million a year. By our definition, the aggregate balance of payments of all countries would show a surplus of about $500 million a year. There are 2 years, by the way, in which the accumulation of gold by all countries outside the Communist bloc was negative. But if we include the gold acquired by the IMF, and we should, this discrepancy disappears. So, by our definition, the sum of all surpluses and deficits will be roughly $500 million, excluding minor errors, where changes in official holdings of foreign exchange somehow got skipped in counting.

By the present definition, as the short-term claims of our own banks and financial institutions increased—by over $2 billion last year, and have averaged probably something well over a billion dollars a year for some time—other countries would have had to include that, to say nothing of other movements of private liquid funds among themselves, as part of the settlement items in their balance of payments.

I don't know what the sum would be, but my guess would be that it could easily be around $2½ billion a year.

Senator PROXMIRE. So there would be an aggregate of about $2½ billion a year in your judgment, roughly.

Mr. BERNSTEIN. I will try to get the figures, but I am guessing somewhere between $2 billion and $2½ billion a year.

Senator PROXMIRE. Would it be possible to get the figures for, say, each of the four or five leading countries of the free world?

Mr. BERNSTEIN. Yes. What we would do, Senator, is to take a half dozen countries that account for nine-tenths or more of these movements, and we will use the figures of the International Monetary Fund, and we will say what the total deficit would be under the present definition of the Balance of Payments Division.

Senator PROXMIRE. Are you maintaining—I don't want to get on a brand new line here—but are you maintaining that—No. 1—our problems would be in balance if we had a zero situation by your definition?

Mr. BERNSTEIN. I claim that.

Senator PROXMIRE. And the world problems would be quite serious, if we had a zero balance of payments situation by the Department of Commerce definition?

Mr. BERNSTEIN. Precisely, that is my contention.

Senator PROXMIRE. You are not arguing the international liquidity problem would be solved.

Mr. BERNSTEIN. No, sir.

Senator PROXMIRE. By our simply obtaining a zero. By your definition, we have to do many other things.

Mr. BERNSTEIN. In 1934, when I was still teaching money, I had a definition of a proper balance of payments which ran something like this: A proper balance of payments for each country is one which lets it get its share of the increment of monetary gold. This would still be true. It would not be true that a zero deficit or a $500 million aggregate surplus for the whole world would provide the growth in liquidity that the world economy needs. Not at all. I am merely saying that if a country, like ours, had a zero deficit by our definition, on an average and over a long period, it would not be confronted with the serious problem of meeting gold outflows or other pressures upon it from the balance of payments. It would still be true that our own liquidity, our own holdings of liquid reserves would not be growing enough, but I would say that that is a problem outside the province of any single country. One country cannot by itself assure that it will get an adequate growth of reserves. We can try to capture the whole $500 million per year that goes into the world's monetary gold stock, but I think we might find competition in acquiring that gold which might have a deflationary effect on the world economy.

Senator PROXMIRE. A zero position on our part would have an international deflationary impact. It would be measurable to the extent of about $2½ billion. Is that correct? It would be a zero position on our part?

Mr. BERNSTEIN. No; a zero position on our part——

Senator PROXMIRE. I am not talking about your definition.

Mr. BERNSTEIN. I am sorry. You are right.

Senator PROXMIRE. By the Department of Commerce definition.

Mr. BERNSTEIN. Sorry, Senator. You are right. A zero deficit for the whole world would have some such deflationary effect.

Senator PROXMIRE. This would be a deflationary impact to the extent, perhaps, of about $2½ billion. Is that it?

Mr. BERNSTEIN. I would not want to guess the amount for all countries in the world. I would rather not make a firm estimate because I have not studied how much foreign assets banks and business institutions in various countries have to add to their working balances and liquid investments each year.

Senator PROXMIRE. Well, I would not want to make it a precise figure, but at any rate, it would be a substantial deflationary——

Mr. BERNSTEIN. If we inverted the proposition, Senator, I think we could say this. If we had a zero deficit by the Balance of Payments Division's definition, there could be no increment of dollars held by foreign companies for working balances. There could be no increase in foreign commercial bank holdings of dollars, either as working balances or in connection with their transactions with other American banks or as an offset to credits they have received here, or in any other form. I would say they would feel the pressure of inadequate working balances of dollars and liquid investments in dollars, roughly, to the extent of between $500 million and $1 billion a year, if our balance of payments as now defined showed a zero deficit over a long period of time.

Mr. KENEN. Could I qualify that in just one respect? The individual private holders could increase their balances, but if it were accomplished from a zero balance for us, it would mean that they would have to increase their holdings at the expense of their own central bank's holdings. In other words, private holders would increase their dollar balances, putting the pinch on the officially held reserves of other countries. And given the desire to increase reserves, this process would impose deflationary pressures; other governments would be forced to take restrictive policies. The inevitable gradual buildup of dollar assets by private foreigners would be accomplished, if you had a zero balance on the Commerce definition, by a depletion of the reserves of foreign monetary authorities.

Senator PROXMIRE. Congressman Ellsworth?

Representative ELLSWORTH. What you have just been saying, certainly it seems to me, focuses attention on the importance of the Congress of the United States giving the most serious consideration, or whoever it is that is going to make the decision about this Bernstein report, to adopting a different definition of the balance than is currently used.

It seems to me, but that's not a question. My question is, again, to all or any of the gentlemen, this: Can a valid case be made for the argument that a key currency country like the United States ought to be required to use a stricter concept of surplus or deficit than would be provided by your official settlements concept?

Mr. BERNSTEIN. In my opinion, it is really the reverse, but I am speaking now as an individual. I am not speaking for the Review Committee. I might put it this way: When foreign holdings of dollars in the United States grow, that is normal for a banking and reserve center for the world.

When American claims on the rest of the world grow—if they don't grow too rapidly—that is normal for a banking center and a reserve center for the world. But if the foreign liabilities of the banks in Columbia grow, or if the foreign liabilities of the banks in Japan grow, that is much more reason for them to be concerned. That is reason to be concerned because that's not normal for them, if they grow too fast.

But I would not say that we need a stricter definition for us. On the contrary, I would say it is because we are a reserve center, because we are a banking center in which any private company or commercial bank in the world having surplus cash now can earn 4 percent, that foreign funds flow in.

There are exceptions, as I mentioned, to the rule that foreign banks send funds here solely because we are a banking center with a broad and liquid money market. When the U.S. Treasury and the German Bundesbank intervene in the forward exchange market to induce commercial banks to acquire more dollars than they would hold on a straight investment basis, there is official intervention in the exchange market. Note, nevertheless, that the inducement to banks to hold more dollars is through the profit motive.

The operation I had in mind is this. The German Bundesbank said to the German commercial banks, "Look, you can earn 3 percent on U.S. Treasury bills. We will give you a deal. We will sell you spot dollars for investment in U.S. Treasury bills, and then give you forward cover in marks at a rate that will yield you an additional 1 percent a year; that is, 4 percent in all." This has been done by central banks on a number of occasions; but the sums involved have never been very large. I don't know what the largest single quarter was.

What was it, John—$250 million?

Mr. REYNOLDS. Something like that.

Mr. BERNSTEIN. $250 million was the largest in any single quarter, and these get reversed after a couple of months. The central banks withdraw their support from such operations, the funds go back, and the cumulative total is zero after a time. Now, I see no reason for changing the method of presenting the balance of payments for this reason.

As I said before, it's very important to get these foreign commercial banks holdings of dollars in a place in our balance of payments where people are induced to analyze their behavior. You get that by putting them into the capital accounts, not by burying them down in the settlement items where they are regarded as passive consequences of everything else that happened.

Representative ELLSWORTH. Thank you very much. Is there any likelihood that the addition of the official settlements concept to our balance of payments statistics would weaken confidence in the dollar abroad? Perhaps by giving the impression that we were trying to solve the problem by altering statistics rather than coping with the fundamentals?

Mr. BERNSTEIN. I don't think there is any danger of that, sir. If there is anybody who really knows what our balance of payments problem is, outside the handful of experts in the Balance of Payments Division and some university professors, it is the European central bankers. They follow it very closely.

I have discussed our payments problem with them for years. They understand very well that there is something about our statistics that tends to exaggerate the balance of payments deficit. I think they would much rather have an accurate thermometer. I think nearly all of them would support the concept of official settlements.

But I think there is a danger that the man in the street, who isn't up on the constituents of the balance of payments of the United States, might say, "Here they are. Instead of solving the balance of payments problem, they are juggling the figures." I know people who are really afraid that this will happen.

Representative ELLSWORTH. Is there any danger that any heads of state might make that argument?

Mr. BERNSTEIN. No. And Congressman, if I had my way, and if it were decided to adopt the official settlements definition, I would continue for quite a while to publish with the official settlements deficit the reconciliation with the deficit on regular types of transactions.

Mr. KENEN. May I add just one point on that same score?

Within the last year, in one of the most difficult years that Britain has faced in a long time, the Bank of England, a conservative institution if ever there was one in these matters, did publish an official settlements balance of payments, not to replace their existing concepts with which they are quite content at the moment, but rather in a feature article in the Bank of England Bulletin. They showed a balance of payments presentation very much like the one that we have proposed for the United States. Mind you, this was published in the front of the Bank of England Bulletin, whereas the regular table appears way far behind. They did not object at all to showing a different presentation at a time when their own balance of payments was in serious difficulty.

They did not, of course, hide anything by doing so. They did not refuse to reveal the old figures, or break the continuity of the series, and I quite agree with what Mr. Bernstein has just said; we would not do so, either. If the U.S. Government did adopt the concept proposed by the Review Committee, I am sure it would want to continue publishing the present series for some time, so that there would be no reason for an accusation that we were fudging the figures.

Mr. BERNSTEIN. One footnote in this. Remember the British do not use the definition of the deficit that our Balance of Payments Division does. They don't use the official settlements, either, but what they do is, in fact, to offset directly the short-term claims and short-term liabilities.

Representative ELLSWORTH. Does the Bank of England Bulletin intend to continue publishing this new thing at the front, and the old one at the back?

Mr. KENEN. As a matter of fact, Mr. Ellsworth, it was just a feature article, inspired partly by the knowledge that we were studying on the subject in this country, and there was some considerable interest in the way the British figures would look arranged according to the official settlements definition.

I might add, by the way, that the definition proposed by the Review Committee and the one shown by the Bank of England in that special article is almost exactly the same as the one which the International Monetary Fund has been publishing for years, not only for Britain, but also for the United States. This definition is not something new and startling.

Senator PROXMIRE. Off the record.

(Discussion off the record.)

Senator PROXMIRE. Then, if there are any questions for Dr. Kenen, you will yield?

Representative ELLSWORTH. I will be glad to; yes, sir.

Senator DOUGLAS. I would like to ask whether this new system of bookkeeping would affect the statistics of international liquidity. I have before me the May volume of the IMF.

Mr. BERNSTEIN. No, sir.

Senator DOUGLAS. It shows that, at the end of 1964, all countries had a total of $41 billion, roughly, in gold holdings, and $24 billion in foreign exchange.

Mr. BERNSTEIN. No, sir.

Senator PROXMIRE. Could I just interrupt for a minute to say are there any specific questions for Professor Kenen?

Senator DOUGLAS. No, sir.

Senator PROXMIRE. Then, Professor Kenen, thank you very much for contributing to our enlightenment.

Mr. KENEN. Thank you very much. Forgive me for having to leave early.

Mr. BERNSTEIN. The International Monetary Fund publishes the liquidity table, which shows gold, net position in the International Monetary Fund, which is the creditor position of each country, and official foreign exchange holdings. It sums up these three, and calls them reserves. But it also has, Senator, an addendum item, foreign exchange holdings of commercial banks.

And, incidentally, this would be a help in answering Senator Proxmire's questions. Because this would show the biggest single constituent resulting in a big negative amount for all of the balance of payments of all the other countries.

Senator DOUGLAS. If Mr. Ellsworth will forgive me, I merely want to follow this up with one question.

If private banks and individuals sold their holdings of dollars to the monetary authorities of their respective countries, then foreign exchange reserves in the international monetary system would increase, wouldn't they?

Mr. BERNSTEIN. Yes, sir.

Senator DOUGLAS. And international liquidity increases, even though the total volume of claims against the dollar or the pound does not increase.

Mr. BERNSTEIN. The statement is unexceptional, provided that when dollars get into the hands of the monetary authorities, our policy remains unchanged. It might very well be that if we saw more of the private dollars getting into the hands of the monetary authorities, our monetary policy would change.

Senator PROXMIRE. Would this have any effect on the domestic monetary system of the country where the exchange holdings of individuals and private banks move into the central system? Wouldn't there be a multiplier effect there?

Mr. BERNSTEIN. I think we can start with the first effect, Senator, and then we can deal with any multiplier we want. When a bank sells dollars to the monetary authority, its bank reserves are increased. Its capacity to lend has been increased.

Senator DOUGLAS. Therefore, its capacity to lend has been increased in a multiple of the balance which was deposited to the central system?

Mr. BERNSTEIN. Well, in all of these things, Senator, to get this multiple, we would have to assume that all banks act together. On the assumption that there is a general movement of foreign exchange from banks to monetary authorities, you could multiply the amount by three or four, depending upon the ratio of currency to deposits, on the ratio of bank reserves to deposit liabilities, and so on, to get the increased lending capacity of the banking system. Provided again that monetary policy abroad is not changed to offset this.

Senator DOUGLAS. Sorry, Congressman.

Senator PROXMIRE. Congressman Ellsworth.

Representative ELLSWORTH. I just have one short question.

Do I understand from the things you have said this morning that you feel that there should be an international agreement as to the single or several concepts of balance of payments which all countries should report?

Mr. BERNSTEIN. I think that it is desirable to have an agreed definition of the surplus or deficit by the great trading countries. When the United States goes into a meeting to discuss our balance of payments problem with Germany, France, the United Kingdom, Italy, Belgium, Netherlands, and others, I think it is essential that when we say, "You are running too big a surplus," and they say, "You are running too big a deficit," that at least there should be some relationship between what we mean by their surplus, and what they mean by our deficit.

I do believe that it is necessary to have such agreement, and what's more, they believe it is necessary. You know, the OECD has committees that have been set up to give much more attention to the balance of payments of these large countries. That is, after all, the best way of getting international cooperation on policies to keep international payments in order, and I think the technicians have indicated that they would be willing to adopt a uniform definition similar to ours?

Have the OECD said anything at all, John, the technicians, at least?

Mr. REYNOLDS. Well, I think it is more feasible in the Fund publications, where you publish tables on the same basis. The OECD has tended to publish a variety of tables, where they show a balance on one basis, and then on another basis.

Mr. BERNSTEIN. Perhaps it is the staff of the Development Assistance Committee that said it would recommend that our definition be generally used?

You know, we run into this problem of asymmetry in lots of other places. The Development Assistance Committee studies what countries do on aid, and there is a feeling that the balance of payments presentation ought to be the same.

Representative ELLSWORTH. Thank you very much.

Thank you, Mr. Chairman.

Senator PROXMIRE. Let me follow that up.

If it should be the same, it would seem to me that there is some argument here that we should try to do this on the basis of some kind of international agreement. If it is going to be the same, why shouldn't we postpone as dramatic and as drastic a change as you have suggested with the hope that we can persuade other countries to agree? After all, I take it from what you have said about the British situation, and perhaps it is true in other countries, that we still wouldn't get an identical system of international measurements if we do go on an offiicial settlements basis. It might be a little closer. But it still wouldn't be talking about the same things when we say deficit. Is that correct?

Mr. BERNSTEIN. If the British keep their system, there would be minor differences from the Review Committee's definition. There would be big differences from the Balance of Payments Division's definition.

Now, you ask why don't we wait for international cooperation? Well, I was chairman of a——

Senator PROXMIRE. I don't say wait for it. I say press for it.

Mr. BERNSTEIN. Yes. I am for pressing for it, but I want you to know the history of this kind of international cooperation.

I was chairman of the first Postwar International Conference on Balance of Payments Statistics. We held it at the International Monetary Fund, and we had representatives from any number of countries. And we agreed on standard classifications and standard reports to the Fund.

We held another meeting in 1953, about then; I have forgotten the exact year. This one was confined to invited countries, including all the big trading countries. And there we were very much concerned with how to deal especially with U.S. aid. Did U.S. aid to a country indicate that the country had a deficit? Did it indicate that we had a surplus, that we had to finance the deficit by way of the aid? We had representatives of the United States there, too, both conferences.

Now, I don't think that an international conference can compel countries to set up balance of payments in a particular form. I think there will always be small variations, partly because of how the statistics are collected.

Senator PROXMIRE. Let me try and refine my question, then.

Would it be your judgment that if we do follow your recommendation and change the Department of Commerce definition of deficit, that we would then be reasonably close, so the differences would be minor and small, and the comparisons would be pretty clear and understandable, the variations modest?

Mr. BERNSTEIN. Yes, Senator, and I would say further that the probability would be that any changes others make would be in the direction of the definition we are proposing.

Senator PROXMIRE. You have been asked this question other ways. I would like to ask it now in terms of the specific timing, the timing of this change.

Many people have argued, including some prominent bankers who are well-informed in this area, that we should not change the definition now or at any time when we are in serious balance of payment difficulties; that to change it now would be subject to a very clear interpretation on the part of many people that we are doing it to give a different figure because some fooling around with statistics makes us look better, you know; that—was it Will Rogers who talked about how "statistics don't lie but liars use statistics"? And there might be that kind of impression, which would be very, very bad.

I am wondering under these circumstances if you feel that it might be wise to postpone this for a while, until we are in a position where we wouldn't be subject to that kind of thing.

Mr. BERNSTEIN. Well, Senator, we have lived 12 years, roughly, with the definition we have today. We did not use that definition before. It was not an unsuitable definition, I might add, for a world in which there were exchange controls and we were afraid of dollar shortages. I would want to be the last one to say, Senator, that if we could live 12 years through such difficult times with these statistics, that we couldn't survive by keeping these statistics.

I want to make it clear, as the chairman of the Review Committee, that neither the welfare of the United States nor the strength of the dollar ultimately depends upon the way we put out our statistics. That will depend upon policies that we follow. I think we are going to have to follow strong policies, whichever definition of the deficit is used.

If anybody wants to wait, I would consider that judgment and the reasons behind it. My own opinion is that there is no need to wait. My own opinion is that the ones who would be most affected in their own responsibility in making policy know what our balance of payments problem really is, and I would go ahead with the Review Committee's recommendation, giving the Balance of Payments Division adequate time to set up the figures in the form of our table. This isn't overwhelmingly difficult, because, after all, where do you think we got practically everything here? We get it from my friend, Walther Lederer. That is because he knows more about these things than I do—at least about the things that are in here.

Senator PROXMIRE. What was that last distinction? More about the things that are in what?

Mr. BERNSTEIN. He knows more about each separate figure in this volume than I do.

Senator PROXMIRE. I see.

Mr. BERNSTEIN. I certainly would say that. He is a very able man. That doesn't mean that his judgment on the definition of the deficit is anywhere near as good as mine.

(Laughter.)

Mr. BERNSTEIN. I hope Walther is still here.

Senator PROXMIRE. He is here.

Mr. BERNSTEIN. I don't want him to think I would say this behind his back.

Senator PROXMIRE. No. He is behind your back.

(Laughter.)

Mr. BERNSTEIN. Senator, I know of no reason why we can't go ahead with the recommendation of the Review Committee.

I would give the Balance of Payments Division, already overworked, time to make the change. By that time, probably, the balance of payments will be considerably better. I would set it up showing the deficit on the official settlements basis, with all of the principal items necessary for a reconciliation. And the last line would be the deficit on regular transactions that the Balance of Payments Division now uses, which of all their definitions, I prefer.

Senator PROXMIRE. You say in your statement, "No single number, however the deficit is defined, can adequately describe the international position of the United States or provide an absolute measure of the payments problem," and then you nevertheless would settle on your one definition.

Mr. BERNSTEIN. Senator, I don't think any two definitions would do it, either, nor any three.

Senator PROXMIRE. Yes, but it seems to me that it raises the point, perhaps, that maybe instead of a definition, what you need is to provide the figure and then let the——

Mr. BERNSTEIN. Well, I wouldn't object to setting up the table. I have no great objection to setting up the table as you suggest. This is personal. The committee might strongly disagree with me. But I think the table would normally lead to our definition of the deficit. Will you turn to table 2 in our summary? (See p. 8.)

Senator Proxmire. Yes.

Mr. BERNSTEIN. Really all you are saying, Senator, is that we should take out item J. You see that?

Senator PROXMIRE. Right.

Mr. BERNSTEIN. And then we would run everything up to H, and then we would have K and L, and I will tell you what the consequence of it will be. If you set up the table like that, everybody will define the deficit as item L, and a lot of people have urged us to measure the deficit by category L. That's what they will do. It is the last category in the table. It is the residual definition of the deficit.

Senator PROXMIRE. I might say what the L.

[Laughter.]

Mr. BERNSTEIN. But by that time it would be changed to K, because we would have to drop category J.

Senator PROXMIRE. I am just wondering what really would be so bad about that? After all, the important thing is to provoke an acceptance and the understanding and the fact that there isn't any simple figure, and that people who say it is 3 billion or 1½ billion, and so forth, are trying to oversimplify something that is basically very complicated. I think the whole thrust of your testimony today is that the need is for a far deeper understanding than any single figure you settle on can provide.

Mr. BERNSTEIN. That is right, Senator. It wouldn't trouble me much, but I want to warn you that the consequence will be that the people will define the deficit as the change in the reserve position of the United States, measured by three items in that category. And next to our own definition, and maybe even more than our own definition, this is the definition that some 200 correspondents who wrote to the Review Committee, and many people in the U.S. Government, have urged on us.

Senator PROXMIRE. This definition that you are using?

Mr. BERNSTEIN. No, the implied definition that would result from not putting any definition.

Senator PROXMIRE. I see.

Mr. BERNSTEIN. Because everybody would then take the last category, what is now L, and say "That's the deficit." That's what they would say, and Senator, and it wouldn't be a bad definition over the long run.

Now I must repeat once more, our definition of the deficit, no definition of the deficit can show the nature and magnitude of the balance of payments problem at any given moment of time.

It can give you an approximation. What our definition of the deficit does, I believe, is to give you a measure that over an average of years does approximate the magnitude of the payments problem. It is a very good definition of what the problem is over a period of time; if it comes out to zero over a 5-year period, it indicates we have no serious payments problem.

With the present definition of the deficit on regular types of transactions, you still couldn't say that any figure in any given year shows you what the magnitude of the payments problem is. But if it averaged minus $500 million a year over 5 years, you could certainly say, "We have no payments problem."

Well, I think there is something inherently inconsistent in defining the deficit so that an average deficit of $500 million or more a year represents a proper balance of payments.

Senator PROXMIRE. You keep saying there is no serious payments problem when by your definition the balance is at zero. On the other hand, you also implied that if it comes out to zero, we are going to lose gold, and we are going to lose a lot of gold, and perhaps lose it in a hurry.

Mr. BERNSTEIN. Well, Senator, that is a short-run problem.

Senator PROXMIRE. Would you spend just a minute or two in telling us what you would do about that? You just sort of left that hanging. I think that is one of the most important contributions you have made this morning—the fact that we are likely to lose a great deal of gold suddenly, when we do succeed in bringing our payments into balance.

What do we do about it?

Mr. BERNSTEIN. I don't want to frighten anybody by saying it is going to be a great deal. My answer to that is again what I said before.

Senator PROXMIRE. You started by saying we ought to know.

Mr. BERNSTEIN. We have to act fast.

Senator PROXMIRE. What does that mean?

Mr. BERNSTEIN. That means that you have got to make your balance of payments so strong that in fact, countries aren't acquiring dollars to convert into gold. If they just have to convert from the stock of dollars they have, there isn't going to be very much conversion. Let met put it to you very simply. If the Bank of France acquires no additional dollars net—and they may not have acquired very much in the past weeks, as the exchange rate for the franc has been below the ceiling for the first time in a long time—if they acquire no more dollars, they aren't going to have very much to convert into gold.

So if our balance of payments becomes strong very quickly, there will be no increment of dollars to convert. Conversions from stock might still go on. The Germans may want to do a little. The Italians may want to do a little. I think it is easy to exaggerate how much there would be. The big danger is to have an improvement in the balance of payments without eliminating the deficit completely, so that there is some new accrual of dollars in their hands.

If they still acquire dollars, but the balance of payments looks better, they may feel that the pressures are off us, and they ought to do as they please.

Senator PROXMIRE. I just have a couple of——

Mr. BERNSTEIN. But Senator, you are entirely right. I can conceive of the United States having a serious problem. You don't have to call it a balance of payments problem. If you wish, you can have a serious reserve problem.

If, with a zero deficit by our definition, present holders of official dollars convert them into gold on a large scale, we would have to respond to that, too.

Senator PROXMIRE. You say in your report that "Lack of information and lack of knowledge of the reliability of data have hampered policymaking."

Now that seems to me to be a very serious charge. The committee in effect accuses the data collecting agencies, the Balance of Payments Division, the Treasury and the Bureau of the Census, of being responsible for inadequate policy actions.

And yet you haven't given us any proof that there is an inadequacy, or has been an inadequacy.

Mr. BERNSTEIN. Of the statistics?

Senator PROXMIRE. Oh, yes, you have given us some proof about your conviction on the statistics.

Mr. BERNSTEIN. You are right, Senator. I tell you, it is hard for me to break the habits of a lifetime. I am not ordinarily a man who likes to make his criticisms on the record, where everybody can say, "Look, Bernstein says the Treasury and Federal Reserve aren't doing the right thing." Because by and large, I think they do do the right thing, and the same thing goes for the Commerce Department. I think by and large, they do a very good job. Now if you want me to document places where the policy has been inadequate, not wrong policy, but inadequate——

Senator PROXMIRE. Why, you know, use the term, "wrong"? What is wrong with that? Senators are always attacking this and that, you know, as being wrong. After all, there is nothing——

Mr. BERNSTEIN. But you have never been a civil servant or an assistant to the Secretary of the Treasury.

Senator PROXMIRE. You are not now, you are independent. You can say anything you want.

Mr. BERNSTEIN. I do say anything I want, Senator. I want you to know, I don't hold back a thing. I just don't publish it.

Senator PROXMIRE. If it is inadequate, it is wrong.

Mr. BERNSTEIN. There is something wrong with it if it is inadequate.

Senator PROXMIRE. Do you document this?

Mr. BERNSTEIN. I am going to try to, yes.

Senator PROXMIRE. I wish you would, before the Department of Commerce people come up here, because I think in fairness to them, it is best to have everything as specific and definite as possible.

Mr. BERNSTEIN. I think so. I think if we are going to say this at all, we had better put it down in A B C.

Senator PROXMIRE. Don't do it gently, do it bluntly. Then we will understand it.

Mr. BERNSTEIN. Senator, we will do our best.

Mr. REYNOLDS. I would just like to say a word, Senator, to say the lack of information has hampered policymaking isn't necessarily to take the same step and say that it has produced wrong policy. As a Federal Reserve employee, I am aware of many cases where lack of information has hampered policymaking. I mean, we have been——

Senator PROXMIRE. Look, you fellows have to make a case here. I am not saying you have to, but if you want to persuade this committee and persuade the Congress and the Appropriations Committee to spend a substantial amount of money, if you want to persuade us that our present statistics need to be changed, and there is bound to be confusion for a while, it seems to me that the price of that is to convince us that there has been wrong policy. You say it has been hampered, but it is all right.

Mr. REYNOLDS. No, I was going on, Senator, to say that I think this sentence refers particularly to the detailed data, rather than to this concept of the deficit. For example, at the Federal Reserve, we have wondered all along how much effect short-term interest rate changes would have on capital flows. Now we have been hampered in making this analysis by not really knowing how big the short-term capital flows are, and by having to make guesses about whether large swings in the errors and omissions items really represent short-term capital flows or perhaps something quite different.

We hope we have guessed right, but we have had to guess where we would have preferred to know. That's all I am saying.

Senator PROXMIRE. So you don't know whether the policies have been wrong or not, but you know they have been hampered, because the statistics have not been available on an accurate or comprehensive basis.

Mr. REYNOLDS. It is very difficult to see the results of the policies, too. You can't be sure. You have a hope that you are reducing capital outflows, but you are not sure you are measuring it well enough to be absolutely certain.

Mr. BERNSTEIN. Senator, with all my reluctance to go into this subject in a critical way, I feel you are right, and I have to put it in.

Senator PROXMIRE. All right, fine. Now just one brief clarification that would be helpful. I notice on page 5 of the report, you have this item that has caused so much discussion, and that is the principal item in understanding what we are talking about, G.

Now I notice that G, which is $1.4 billion in 1964, the year in which there was such a difference in your measurement, has been erratic and it has been much smaller than that during most earlier years. In 1962, it was an actual minus figure. Minus $100 million. And I am wondering if maybe we have paid so much attention to G that we have ignored what you said on your first page in your last paragraph, when you said that there is another element, too, prepayments on military sales, for example. It is in the same category as this. Is that correct?

Mr. BERNSTEIN. No, sir; not in G.

Senator PROXMIRE. Well, you say the Review Committee includes in ordinary transactions above the line prepayments on military sales which it regards as not essentially different from prepayment on any other U.S. export orders. It includes in ordinary transactions—and the second, and this is G, I take it—"changes in all private holdings of short-term"——

Mr. BERNSTEIN. That's G.

Senator PROXMIRE. "And liquid dollar assets." However, you would change both these things.

Mr. BERNSTEIN. Yes, sir. And also the treatment of international nonmonetary institutions.

Senator PROXMIRE. What I am getting at is, have you concentrated so much attention on G, just because it was a big spectacular change in the last year?

Mr. BERNSTEIN. And also for another reason. That is the category in which the interrelation of the monetary authorities with specific market transactions can be shown.

Senator PROXMIRE. I see.

Mr. BERNSTEIN. We can show the monetary authorities intervened there. Of course we intervene to get military sales and collect the money, but actually, the classification of prepayments under military sales was mainly a 1-year bookkeeping item. It is not ordinarily of great consequence. The flows of military supports now match the payments, approximately. Differences are not likely to be very large. Nobody need be troubled about that. That is also true of the international nonmonetary institutions.

There have been years in which the figures have been large. I don't think they are going to average very much in the future. But the claims of commercial banks are very responsive to monetary conditions. When money is very easy here and tight in Europe, you are likely to get a much smaller increase in dollar holdings of foreign commercial banks. Some of them may even bring money home.

When interest rates are a little higher here, they may keep the money here. It is not an accident that 1959 and 1964, in which money was being tightened, were the years when foreign holdings of dollars increased most. But, Senator, there are other things that enter into this pattern of behavior too.

Senator PROXMIRE. What I am getting at is perhaps if I were making this recommendation in 1963, and were basing it on the 1962 experience, since G was so small, you might not have had as forceful a case.

Mr. BERNSTEIN. No, Senator, we have had this on our mind a very long time.

Senator PROXMIRE. I know you have, but do you have the evidence to really make a strong case that there would have been much difference? A hundred million dollars?

Mr. BERNSTEIN. Senator, let me put it this way. We have the figures here, and we can start far back. Foreign private holdings have been growing at a steady rate, an average of $460 million a year for foreign commercial banks and $155 million a year for other private holdings over the past 10 years. It is true in some years, when money rates are low here, the inflow of liquid funds is smaller as banks and others put more money in other markets. In years when they can earn more in our markets, they put more money here. The year-to-year difference in the inflow of funds disguises the gradual and continuous rise of such holdings.

Senator PROXMIRE. Well, let me just take a minute to go over this. Net increase beginning in 1954. Short-term claims of foreign commercial banks reported by U.S. banks, net increase, 1954, zero; 1955, $400 million; 1956, $400 million; 1957, $100 million; 1958, zero, 1959 was a big year, $1.1 billion; 1960, $100 million; 1961, $600 million, 1962, minus $100 million; 1963, $400 million; and then 1964, of course, was the big year, $1.4 billion.

Mr. BERNSTEIN. Senator, how far back does this go?

Senator PROXMIRE. That goes to 1954.

Mr. BERNSTEIN. Senator, may I make another point? This is not an insignificant item, because even without last year, you see, it would average $400 million a year. And when you add the private holdings, you might get another $150 to $200 million a year, and we are in fact talking about a change in the definition of the order of $500 million to a billion a year. It is a fact that the figures are larger now, but there are several reasons why they are larger.

First, exchange control has been eased in Europe, and has given more freedom to banks to keep money here, and they are very eager to earn the money. International banking transactions have become very much greater. So banks feel they have to keep deposits with each other—our banks with foreign banks, the foreign banks with our banks.

I don't think the magnitude of the figure last year was in any way determining. My personal view is that much of it represented capital outflow from the United States which found its first resting place in banks before it could move into the stream of transactions for other purposes. I think there will be a much smaller inflow of foreign bank funds in 1965. It wasn't the last year's figures that in any way determined us.

Senator PROXMIRE. I am sure it didn't. You have had this study going on for 2 years.

Mr. BERNSTEIN. That is right. As a matter of fact, I would much have preferred to have the figure smaller, so that the argument that this is loading the statistics would have been that much weaker.

Senator PROXMIRE. Well, psychologically, we would be in a much better position.

Mr. BERNSTEIN. I think we would have.

Senator PROXMIRE. We can expect the charge that we are reducing our deficit a billion dollars by fooling around with the statistics, which a lot of people perhaps unfortunately assume.

Mr. BERNSTEIN. Strongly.

Senator PROXMIRE. We wouldn't have that if we had a year like 1962.

Mr. REYNOLDS. But 1965 may be like that.

Mr. BERNSTEIN. That is right, 1965 is going to be more like that. I doubt whether the increase in foreign private dollar holdings will be more than 500 million this year, but this is a guess.

Senator, I would have preferred a figure that wouldn't have raised this specter of loading the figures. But foreign banks do what is in their interest and last year they wanted to increase their dollar assets by an enormous amount. This year they will increase them very much less.

Senator PROXMIRE. Well, Dr. Bernstein and Dr. Reynolds, I want to thank you gentlemen very very much. This has been most helpful and enlightening and what I would like to do with your permission, is to submit a series of questions which the staff has compiled, and which we haven't asked you, and possibly some other questions. We will submit them soon, and you could reply for the record, in writing.

Mr. BERNSTEIN. Yes, sir.

Senator PROXMIRE. That would be very helpful to us, and then you would have that record available to the other witnesses when they come before the committee.

(The questions and answers referred to appear in the Appendix following.)

Mr. BERNSTEIN. I thank you very much, too, Senator, on behalf of my colleagues. We found this very enlightening. We don't think we have exhausted what can be said on this subject, and we are glad to have your questions in writing. It will help us to put in some of the points we missed.

Senator PROXMIRE. Thank you very much, Mr. Bernstein. The subcommittee will stand in recess until the 8th of June.

(Whereupon, at 1 p.m., the subcommittee recessed, to reconvene at the call of the chair.)

APPENDIX

EMB, Ltd.,
Research Economists,
Washington, D.C., June 21, 1965.

Senator William Proxmire,
Committee on Banking and Currency,
U.S. Senate, Washington, D.C.

Dear Senator Proxmire: I enclose answers to the questions submitted by the Joint Economic Committee to the Review Committee for Balance of Payments Statistics on May 13. These answers were drafted by Mr. John E. Reynolds who served as staff director for the review committee. I am in broad agreement with what he has written and believe that it represents the viewpoint of the committee.

Sincerely yours,

Edward M. Bernstein.

Questions Submitted to Review Committee by the Joint Economic Committee and Answers Thereto

(Drafted by John E. Reynolds, Staff Director for the Review Committee, and Reviewed by Edward M. Bernstein, Chairman of the Review Committee)

Question 1. In what instances have deficiencies in the data hampered policymaking or led to policy errors? If there were such instances, did the Government attempt to obtain the needed data, and what were the results? What data were requested which couldn't be obtained?

Answer. The Review Committee stated (p. 1 of its report) that "sometimes lack of information and lack of knowledge of the reliability of the data have hampered policymaking. Although there is no reason for thinking that wrong policy decisions have been made because of deficiencies in the data, it is possible that this could occur in the future."

A number of specific instances in which data deficiencies and uncertainties have hampered policymaking were brought to the attention of the Review Committee and are described below. It will be seen from these cases that the problem is rarely a simple one of ascertaining a few closely specified figures. Instead, what is usually needed is a rather wide-ranging improvement and testing of a substantial body of interrelated data. Business has generally cooperated fully in Government efforts to improve the data. The two main obstacles to improvement have been a shortage of Government staff and difficulties inherent in the nature of the transactions to be measured.

CAPITAL MOVEMENTS

Uncertainty about the completeness and accuracy of data on capital movements has posed a variety of problems for policymakers. The devising and appraisal of monetary and debt management policies to limit outflows of short-term capital have been hampered by uncertainty as to the size, nature, and destination of such flows, and also by uncertainty about their causation and susceptibility to policy variables. The Treasury and the Federal Reserve banks (as described in chapter 6 of the Review Committee's report) have made strenuous efforts to improve the coverage and accuracy of reporting on Treasury foreign exchange forms. Also, the forms have been revised to show additional detail, and have been supplemented by periodic reports from particular groups of reporters (e.g., corporations with large holdings of liquid assets abroad).

But serious data problems and consequential analytical problems remain to hamper policymaking and appraisal. As discussed in chapter 7 of the report, the behavior of the net errors and omissions item in the balance of payments suggests that a considerable volume of capital flows (probably long-term as well as short-term, and including both United States and foreign capital) is not covered in the data now collected.

In judging the net impact of direct investment transactions, and in weighing proposed policies to influence flows of direct investment capital and earnings (e.g., through tax incentives or disincentives), the Government has been hampered by data deficiencies and uncertainties. The Balance of Payments Division (BPD) in the Office fo Business Economics (OBE) has an excellent reporting system for direct investments, and has collected increasingly detailed information in this important field. But it has been very short of staff to tabulate in detail, and analyze, the resulting information. Last year, the OBE was denied the funds that it requested to conduct the first census since 1957 of U.S. direct investments abroad.

Implementation of the President's program for voluntary limitation of capital outflows has been hampered by lack of information. For example, when the Federal Reserve first framed its "Tentative guidelines for nonbank financial institutions," it had almost no information on the foreign investment holdings of, and flows through, these institutions. Special reports have since been obtained from them, and also from banks, for which insufficient data were previously available.

GOVERNMENT TRANSACTIONS

The Defense Department, in weighing alternative possibilities for reducing military expenditures abroad, was initially hampered by lack of data. Special surveys have since been made of the pattern of expenditure by personnel stationed abroad, and reporting techniques have been developed that help to measure the foreign expenditure component of contractual services and procurement. Nevertheless, data gaps and uncertainties remain, as discussed in chapter 4 of the report.

The Agency for International Development, and other agencies concerned with foreign grants and credits, have been hampered in their policies by lack of detailed data on the foreign disbursement and use of funds. Here, too, considerable progress has been made, but problems remain.

TRAVEL

The U.S. Travel Service has repeatedly sought, through the BPD and the Budget Bureau, to improve the statistics on tourism because the available data are inadequate to provide guidance as to ways in which travel by foreigners in this country may be most effectively promoted and the extent to which promotion efforts are succeeding. As noted in chapter 3 of the Committee's report, these statistics pose peculiarly difficult problems of sampling and nonresponse, and while efforts at improvement have been made, it may be that the kind of market research needed by the Travel Service does not fit logically into the general balance of payments statistical program.

GENERAL PROBLEMS

There are a number of ways in which data deficiencies hamper policymaking from a more general point of view. To cite one example, throughout the recent years of U.S. payments deficit, it has been important for policymakers to assess overall trends in order to judge to what extent the payments problem was gradually being solved by market forces and to what extent its solution required policy actions. An important part of this assessment has concerned the way in which the U.S. competitive position was developing. Judgment on this has been hampered by lack of reliable indexes of export and import prices. Also there has been room for doubt about the quality of the export and import statistics. It was at one point suggested to the Review Committee that the upward trend in the export statistics, together with the increased negative errors and omissions item, might both have reflected some progressive overstatement of export values. This could have resulted, for example, if U.S. exporters, under the pressure of foreign competition, were increasingly quoting (and entering on export declarations) delivered prices, rather than prices f.o.b. the United States. Until the accuracy of the export statistics are checked in the way the Committee (and the Census Bureau) have proposed, this possibility will remain untested.

Another range of general problems concerns the relationships between different types of international transactions (e.g., between capital outflows and exports, between capital outflows and capital inflows). The making of policies designed to affect the balance of payments must take these relationships into account, but is hampered in doing so by a wide range of data deficiencies and uncertainties.

Question 2. Which of our balance-of-payments statistics most urgently need improvement?

Answer. While the large number of specific recommendations made by the Committee cannot be precisely arrayed in order of priority, the following areas seem particularly ripe for improvement, from the point of view both of urgent need and practical possibilities.

DIRECT INVESTMENTS

A census of U.S. direct investments abroad is urgently needed, for the reasons given in chapter 5 of the Committee's report. None has been taken since 1957; meanwhile the outstanding book value of such investments has nearly doubled, and the annual flows of capital, earnings, and related transactions have become very large. The OBE budget proposals now before the Congress would provide funds for such a census.

On the basis of a census, current reporting could be tested and no doubt improved. Current reports could also be improved through modest staff additions at OBE to permit more frequent and systematic consultation with reporting companies.

OTHER CAPITAL MOVEMENTS AND OUTSTANDING HOLDINGS

The Treasury-Federal Reserve program to improve current reporting should continue vigorously. In addition, benchmarks are urgently needed, particularly for holdings of securities. Tabulations of tax returns could yield fruitful results here, as they have on occasion in the past. The kind of survey that the Federal Reserve has had to make very hastily for nonbank financial institutions should be conducted more thoroughly. More accurate and reliable data on asset holdings would yield better data on investment income.

MERCHANDISE TRADE

The accuracy of the import and export statistics should be tested as soon as possible by means of sample surveys. Trade data, including time series for past periods, should-be-published in a form more accessible and convenient for purposes of balance of payments analysis. (The Census Bureau has already worked out concrete proposals for these actions.)

Current programs to check the accuracy of commodity coding of exports and imports should be broadened to include checks on valuation.

METHODOLOGY

There is an urgent need for an up-to-date written account of the content of all the various statistical series that make up the balance of payments, the methods by which they are compiled, and their known or suspected shortcomings. Equipped with such a methodology, users of the statistics would be able to use them much more intelligently, and to contribute to their improvement.

Question 3. Should the Commerce Department's Balance of Payments Division reallocate its resources, placing more emphasis on certain data than on others, or more emphasis on data collection and less on analysis? Where in the Government should the analysis work be concentrated?

Answer. The Review Committee found no need for reallocation of the resources of the BPD. It did find a serious overload of work spread throughout the BPD.

As stated in the report (pp. 6 and 172–173), analytical work should be assigned about as it is now, with basis analysis concentrated in the BPD, but with policy-oriented analysis necessarily also being conducted in the policy agencies. There seems a clear need for more thorough analysis, and especially for better coordination of the analytical work performed by different agencies.

Question 4. How much in additional appropriations would be necessary to meet the Review Committee's recommendations for additional and improved data?

Answer. The Committee did not cost its proposals closely, but did satisfy itself that the costs would be modest. It found that the staff of the BPD should be increased by perhaps 15 to 20 persons, or by roughly one-third. The cost of this expansion might come to something like $200,000 a year. It could not all be undertaken immediately, and we have the impression that present budget proposals of the OBE look toward about this much expansion over the next few years.

It appeared to us that the improvements recommended in the merchandise trade statistics that would be carried out by the Census Bureau could be accomplished within the present foreign trade budget at Census of more than $3 million a year. Similarly, increased emphasis by the Customs Bureau on checking the accuracy of valuation might fit within present programs.

Recommended staff expansion at the Office of Statistical Standards and at the Treasury Department would probably involve less than half a dozen additional people.

Question 5. Wouldn't it be more appropriate to include the analytical concept of the deficit in a separate table clearly identified as being part of the analysis rather than in the basic table on the balance of payments?

Answer. The Committee considered this idea, but found it impractical. It is impossible to tabulate international transactions without choosing some method of classifying them and some sequence in which to list them. These choices unavoidably involve analytical judgments, even if every effort is made to hold these to a minimum. (For example, almost everyone would put U.S. gold transactions near the bottom of the table, treating them as somehow the result of other transactions.)

Once the table has been set up, some lines in it are almost certain to be picked out by readers as representing a summary of the position. Bearing this in mind, the compiler can hardly avoid giving some thought to the particular lines toward which the eye will be guided.

The BPD originally attempted, in the Survey of Current Business, to keep its table 3 analytically neutral, and to make table 1 a brief analytical summary. But in fact, table 3 contains summary lines that are referred to as overall balances. And table 1, in the attempt faithfully to summarize a complex situation, has grown to such proportions that it is now commonly regarded as the main balance of payments table (and provides the only summary of seasonally adjusted data). The two have become duplicative, and confusingly so. This history supports the idea that some analytical summarization is unavoidable in a balance of payments table.

There is still, of course, room for analytical tables flexibly devised and frequently rearranged to shed light on particularly interesting facets of the situation. The point is that even a standard table, aimed at analytical neutrality, cannot wholly avoid implications about the analytical cone of a deficit or surplus, and ought therefore to face them squarely.

It would be possible, in the Review Committee's recommended standard table I (pp. 128–129 of the report) to omit line J "Balance settled by official transactions." But then readers would almost certainly focus their attention on what is now line L "Reserve transactions," and regard that line as summarizing the position or measuring the surplus or the deficit.

Question 6. Should those in charge of balance of payments policies be guided in their policy decisions by the same factors that guide other countries, although the dollar is an international medium of exchange while other currencies (with the exception of sterling) are not?

Answer. Certainly U.S. policymakers should be guided not only by all the factors that guide other countries but also by those factors that are unique to the United States. For example, the United States has large liabilities to foreign private and official holders. Many other countries do not. The United States also has large claims on foreigners, whereas many other countries do not. We have broad and active money and capital markets, unlike those of other countries. And so forth. U.S. policymakers will naturally pay attention to the behavior of these unique elements in the U.S. situation, as well as to elements that are similar to those in other countries. They will worry, for example, when foreign central banks acquire large dollar holdings which they are known to wish to convert into gold. Few other countries will encounter this particular kind of worry.

Question 7. We see on chart 1 of the Review Committee's report that the deficit settled by official transactions has fluctuated more sharply and changed directions over time more frequently than the deficit as presently defined. Can such an erratic series be satisfactory as a guide to policy?

Answer. It did not appear to the Review Committee that one measure was much more erratic than the other. Chart 9.5 shows that the quarterly variations in both measures have been very large.

Clearly, policy cannot and should not swing to and fro on the basis of short-run fluctuations in a single indicator. As argued in chapter 11 of the report, policymakers must rely instead on thorough and detailed analysis of the whole balance of payments. Any one-line summary merely provides a starting point for analysis. But the movements shown in charts 1 and 9.5 are not well described by the word "erratic." They resulted from combinations of events that it was important for for policymakers to appraise.

Stability in a summary series is helpful if it means something. But stability cannot be a primary criterion for economic classification. For example, a large part of the fluctuation in both measures of the deficit shown in chart 9.5 arose from fluctuations in outflows of U.S. private capital. Smoother lines could be achieved by classifying such outflows as settlement items below the line. But there is no convincing analytical reason to do this, and the resulting smooth indicator would not be very useful to policymakers.

Question 8. While it is generally assumed that a growth in dollar holdings is consistent with the growth in world trade and payments, how do you account for the large year-to-year variability in dollar accumulations reported for foreign private holders? How can we safely assume that extraordinary accumulations, such as that in 1964, can be counted as if they indicated a viable improvement in our balance of payments position?

The growth trend and also the year-to-year variability in foreign private accumulations of balances in the United States are illustrated in charts 9.1 and 9.3 of the Committee's report. The admitted general assumption that some growth in these holdings is normal is one powerful reason for not counting that growth as evidence of disequilibrium or deficit.

The reasons for short-run variations in foreign private holdings deserve to be studied in great detail. They have not yet received sufficient study, in part because so long as foreign private holdings are lumped together with official settlements below the line, they tend to be regarded as passive items which it does not seem necessary to analyze in diagnosing "the deficit."

Undoubtedly a wide variety of forces produce short-run fluctuations in foreign private balances in the United States. Changing monetary conditions, here and abroad, are an important influence (e.g., in 1959, when U.S. interest rates rose sharply, and in late 1960, when credit eased in the United States and tightened sharply in a number of foreign countries). Changes in outflows of U.S. capital have also sometimes been important (as when U.S. corporations have placed funds with Canadian banks which the latter have then placed in the New York money market). Speculative attitudes may also have been important, particularly late in 1960 (when uncertainties of various kinds cumulated in a flareup of demand for gold in London) and in late 1964 (when some of the foreign funds that moved out of sterling probably moved into dollars).

No one should assume that an extraordinary increase in foreign private holdings of U.S. balances will be maintained. (Just as no one should assume that a sudden rise in wheat exports to Russia will be maintained, or that a sharp rise in direct investments abroad marks the start of a trend.) All balance of payments developments require study to see what has caused them and what the prospects are for their continuation or reversal. On the other hand, as noted in the answer to question 7 above, the fact that particular kinds of transactions are changeable obviously does not tell us whether they should or should not be treated as settlement items.

Question 9. Have any wrong policy decisions been made because of the way the balance of payments deficit has been defined?

Answer. The Review Committee was not asked to appraise policies, and did not attempt to do so. No instances of wrong policies arising from the definition of the deficit were brought to the Committee's attention.

The Committee did, however, consider it possible that at some future time, when there might be a deficit on one method of calculation but not on another, it would be important for policymakers to weigh their definitions very carefully in order not to combat, as a deficit, a growth in foreign private assets that might better be viewed as normal and sustainable or, on the other hand, in order to avoid being complacent about a loss of reserves and an increase in U.S. liabilities to foreign monetary authorities merely because these happened to be matched by a decline in foreign private dollar holdings.

Question 10. The impression has been created that the major countries use the official settlements concept recommended by the Review Committee. But the fact seems to be that most of the major countries do not use the official settlements concept. Foreign assets of banks and banking liabilities to foreigners enter into the balance of payments measure used by the United Kingdom, France, Italy, the Netherlands. Isn't their concept of the balance closer to the one used by the Department of Commerce than the official settlements concept recommended by the Review Committee?

Answer. It is true that there is at present great diversity among major countries in their concepts of overall balance. Germany, Japan (and, in some tables, Canada) come close to using an official settlements concept, since they place below the line as settlement items only official reserves (net in the case of Germany, gross in the case of Japan and Canada; Canada's main emphasis in analysis, unlike other major countries, is on a line between the current and capital accounts). When a country has no significant liabilities to foreign monetary authorities, its official settlements consist entirely of changes in its reserve assets (abstracting from the question of debt prepayments, which are not handled differently in the Review Committee's proposals than in the present Commerce Department treatment).

France and Italy put commercial bank short-term assets and liabilities below the line with net official reserves. The Netherlands distinguishes between liquid and nonliquid short-term assets of commercial banks (the latter are small in amount) and puts the former below the line along with commercial bank short-term liabilities. The United Kingdom places all short-term assets and liabilities below the line, not only those of banks.

The United States is the only major country that puts short-term assets of commercial banks on one side of (above) the line and short-term liabilities on the other (below). We would come closer to the concepts of other countries if both were above the line, as in the official settlements classification, even though differences and asymmetries would remain.

If international symmetry is desired, as well as uniformity, the only system with any practical chance of near-success seems to be the official settlements arrangement. If all countries were to place the assets and liabilities of their banks below the line, their accounts would be asymmetrical to the extent that their banks do business with private foreigners other than banks.

It may be noted that the IMF, endeavoring to show comparable and symmetrical figures for the overall balances of a large number of countries in its annual reports, uses the official settlements concept.

Question 11. The Review Committee cites dealings in the Euro-dollar market as an example of new kinds of transactions that have emerged in recent years for which the present data collecting system may be inadequate. But a large part of transactions in this market are among foreign residents. Who should be responsible for the collection of information concerning those transactions and how should they go about it?

Answer. The U.S. balance of payments records only transactions to which U.S. residents are a party, and therefore should directly reflect only U.S. participation in the Euro-dollar market. Foreign resident's transactions in the Euro-dollar market should be recorded in the payments statistics of foreign countries, and most of the countries concerned try to include them, although in some cases only on a net basis as yet. Thus the main responsibility is a national one.

Nevertheless, collection of data on the Euro-dollar market is a prime candidate for cooperative international efforts for several reasons. The main one is that in order to analyze the market and understand an individual country's participation in it, one has to take it whole. Euro-dollar transactions typically involve long chains, with successive banks in several countries lending to each other, and it is difficult to appraise single links in these chains, both from the point of view of causation and relationships to other transactions, and from the point of view of the soundness and sustainability of the transactions (as has recently been illustrated by the repercussions of individual business failures in widely separated countries). Secondly, Euro-dollar data collected from banks in several countries are more susceptible to cross-checking than are data on most other classes of international transactions, so that international cooperation in data-gathering quickly bears fruit.

In recognition of these facts, the Bank for International Settlements has taken the lead in organizing systematic and cooperative reporting of Euro-dollar transactions, and the countries concerned have developed a considerable body of new and useful data in a remarkably short period of time. Also the United States and Canada have been cooperating particularly closely in this field. In addition to producing data on, and understanding of, these complicated transactions, international cooperative efforts have had useful byproduct effects in showing up some of the shortcomings of related national banking data, and pointing the way to improvements.

Question 12. The Review Committee, commenting on the Euro-dollar market, uses the example of a South American central bank acquiring dollars and depositing them with a commercial bank in London. The latter thus acquires a dollar deposit in a U.S. bank. The Review Committee states that this series of transactions should not be recorded as a U.S. deficit because British, not U.S. banks, have increased their dollar liabilities to central banks.

(*a*) Should the British, then, record a deficit in their balance of payments in this instance, and not the Uuited States whose overseas expenditures gave rise to the increase in foreign official dollar holdings?

(*b*) Would the Bank of England, in its December 1964 article "The Balance of Payments: Methods of Presentation," have shown the increase in these dollar liabilities as part of its deficit under "compensatory official financing"?

Answer. The British should indeed record in their balance of payments the London bank's dollar liability to the South American central bank. They do attempt to record it now. But for United Kingdom dollar liabilities, unlike sterling liabilities, their statistics do not yet distinguish between liabilities to private and official foreigners, and hence could not do so in the article referred to.

It may well be that if the British were to adopt an official settlements concept, they would balk at the idea of recording as evidence of a deficit a foreign-currency liability to a foreign monetary authority that was matched by a private foreign-currency claim of another foreigner, even though they would record separately a sterling liability even if matched by a sterling claim. In the former case, if they could be sure that their function was purely that of a middleman (i.e., that the dollars received had not, say, been sold to the Bank of England for sterling), they might wish to net the transaction out of their balance of payments for purposes of calculating the deficit. If so, their official settlements concept might not be quite symmetrical with that advocated for the United States by the Review Committee. This hypothetical possibility, however, does not appear to weaken the Committee's case so far as the U.S. statistics are concerned.

(It should not be assumed, as suggested in the phrasing of part (a) of this question, that every rise in foreign official dollar holdings results from overseas expenditure by the United States. See question 15 for a different case.)

Question 13. Your Committee emphasizes the compensatory, or passive role of the monetary authorities in filling gaps in the supply of, and demand for, foreign exchange. How does this recognize that monetary authorities use the foreign exchange market for other purposes to pursue active policies such as:

(*a*) achieving the desired level of foreign exchange reserves.

(*b*) expanding or contracting domestic liquidity in their own country.

In view to these active policy considerations wouldn't it be more accurate to suppose that changes in private holdings of foreign exchange depend on official policy decisions, rather than the other way around?

Question 14. Doesn't the idea of official agencies meeting the gaps between demand and supply for foreign exchange imply that foreign private agencies are free to purchase and sell foreign exchange?

(*a*) Is that a valid assumption for all countries which hold dollar reserves?

(*b*) If privately held dollars are officially controlled, does it make sense to speak of the authorities as filling gaps in private supply and demand?

Answer. The Committee did not intend to suggest that central banks may not pursue active policies, including active policies in foreign exchange markets. But their activity is constrained by their obligations to maintain exchange rates within stated margins, and in many situations they must act for this purpose whether they particularly wish to or not.

If a central bank or government deliberately shapes its policies in such a way as to produce increases in its foreign exchange reserves or decreases in reserve liabilities, one would simply say that it is endeavoring to produce a surplus on official settlements. This seems quite a useful way of describing the situation. Thus Britain in coming years must seek a payments surplus with which to repay its recent drawings from the IMF and reconstitute its reserves. The policies adopted for this purpose are not, of course, limited to foreign exchange market policies, but may include the whole arsenal of taxation, credit restraint, incomes policy, and so on.

Similarly, any policies adopted primarily for domestic purposes, such as expanding or contracting domestic liquidity, will usually have effects on the balance of payments. It is, indeed, impossible to imagine how one could attempt to measure what the balance of payments situation would have been in the absence of policy of any kind.

The fact that central banks may pursue active policies of various kinds for various purposes would not seem to prove that changes in private holdings of foreign exchange depend on official policy decisions. They may be influenced by policy decisions, but that is a very different matter. Most other international transactions, including exports, imports, travel, long-term investment, and so forth, are also influenced by policy decisions, and yet, they, like changes in holdings of short-term claims on foreigners, are best viewed as autonomous within those constraints, rather than as wholly determined by policy.

The idea of official agencies meeting the gaps between demand and supply for foreign exchange does indeed imply some degree of freedom for foreigners to purchase and sell foreign exchange. There is in fact such freedom; otherwise there would be no foreign exchange markets. The degree of freedom may vary considerably from time to time, from country to country, and from one kind of transaction to another. It is difficult to imagine any transaction that is wholly unaffected by policies or regulations of any kind. But this fact cannot make nonsense of one particular deficit concept without destroying them all.

It may be argued that private holdings of foreign exchange are particularly closely controlled or regulated in many countries. To the extent that they are in fact restricted to small proportions and allowed to change little, they are rather unimportant in the balance of payments. When they are permitted to increase, the fact that they do increase results from autonomous private decisions; the cases in which the authorities require private parties to hold foreign balances against their wishes must be very rare. And however much the holding of private balances is restricted, there will still be gaps for monetary ausorities fo fill between demand and supply of foreign exchange for other purposes. The authorities alone have a responsibility for maintaining the stability of exchange rates. Private transactors have no such responsibility, although public policy may of course seek to influence private behavior in ways that minimize the gaps.

Question 15. Under the official settlements concept, transactions just among foreigners could add to our balance of payments deficit. This would come about if private residents in one country transfer dollars to an official agency in another in payment for trade or other obligations, or if within a foreign country dollars are transferred from a private holder to the monetary authorities.

(*a*) Does it make sense to record transactions as deficits—possibly even to adopt restrictive policies—when they had absolutely nothing to do with U.S. international payments and receipts?

(*b*) Do transfers of dollars between private and official foreigners necessarily result from weaknesses in the dollar?

Question 16. The Review Committee regards increases in foreign dollar holdings as a sign of strength of the dollar and increases in the dollars held by foreign monetary authorities as a sign of weakness.

(*a*) Should we be pleased to see substantial increases in foreign private dollar holdings relative to our reserves?

(*b*) Don't increases in privately held dollars abroad add greatly to the instability of the system, because they can be sold at will?

(*c*) Isn't the real threat to the dollar today the large private dollar holdings abroad rather than officially held dollars, since international monetary cooperation would tend to keep foreign official institutions from converting much of their present dollar reserves into gold?

(*d*) Didn't the recent British foreign exchange crisis come about because of conversions by private, not official, holders of sterling?

Answer. A wide variety of events that occur outside the United States may influence our payments deficit, however it is defined. A war scare may raise the price we pay for sugar. A European slump may hurt our machinery exports. A Canadian devaluation may induce an increase in U.S. travel expenditures. The list is as long as history. There would seem to be no inherent logic in the argument that one particular kind of foreign event—the transfer of dollars from private to official account—should not be capable of affecting our balance of payments position. And, in fact, there is one obvious case where such transfers can have such important effects that responsible U.S. policy must respond. That is the case in which a currency crisis develops, and private foreigners (and Americans) rush to unload their dollars on foreign central banks.

Obviously transfers of dollars from private to official foreigners do not result only from bearishness about the dollar. They can occur for many other reasons, most commonly as a result of changing credit conditions. If, for example, the Netherlands Bank tightens credit in order to fight inflation, it may as a result acquire dollars from Dutch commercial banks. It may also acquire dollars from U.S. investors who find financial assets in the Netherlands an attractive buy at the new lower prices and higher yields. Thus, flows both of foreign private capital and of U.S. private capital may be induced by changes in monetary policies.

All other things being equal, shifts of foreign-owned claims on the United States from official to private hands reduce a U.S. deficit on official transactions. Increases in foreign private holdings as a result of other nonreserve transactions would not affect the deficit, the two transactions being offsetting. What view one should take of a situation in which foreign private holdings are rising while reserve assets and liabilities are unchanged would depend on an analysis of the pattern and sustainability of the whole network of international transactions. There would be, for the moment, no deficit on an official settlements basis. U.S. private claims on foreigners might well be rising as fast as, or faster than, foreign private claims on the United States. The question for analysis, as always, would be whether the pattern seemed sustainable, or whether new developments were pointing toward a new imbalance. But the main signal of imbalance would not necessarily be the rise in foreign private short-term claims. It might be, instead, an impending foreign recession, a U.S. inflation, or any number of other things. No particular constellation of private transactions is a priori pleasing or displeasing in this connection.

It is true that privately held foreign balances in this country can be sold at will. So can U.S.-owned balances. So can many longer term securities. In most historical cases of currency crisis, capital flight by domestic residents has played at least as important a role as the flight of foreign private capital.

It is difficult to see why foreign private claims on this country are more a threat to our currency than are U.S. private claims on foreigners a threat to foreign currencies. The authorities, say, of this country and Canada would be working at cross purposes if each regarded the others private claims as a threat. The argument that international monetary cooperation keeps foreign official institutions from converting dollar reserves into gold has been to some extent contradicted by events of recent months; and it is hard to see how foreign private holdings are a threat if it is assumed that official institutions are so constrained, since foreign private holders cannot buy gold here.

The Review Committee has not studied the recent British foreign exchange crisis. But there is apparently some evidence of foreign official as well as private conversions of sterling, and ample evidence of conversion and other anticipatory actions by United Kingdom residents as well as by foreigners.

Question 17. Don't foreign purchases of our gold reflect private as well as official acquisitions of dollars? It is well known that private foreigners have borrowed dollars when their own governments tightened credit. To prevent the frustration of their monetary policies, isn't it likely that the foreign authorities, to get us to stop the outflow of dollars into private hands, would convert some of their own dollars into gold? In fact, can't we interpret recent gold purchases in this light?

Answer. Recent conversions by foreign monetary authorities of dollars into gold have probably been undertaken for a number of reasons, one of which may have been to bring pressure on the United States to take action to improve its balance-of-payments position, and, in particular, to reduce outflows to U.S. capital. But there seems little reason to suppose that accumulations of foreign private claims on the United States have been an important irritant.

When foreigners borrow in the United States, such borrowing may run counter to the efforts of foreign monetary authorities to tighten credit. But if the funds are borrowed for the purpose of spending them, or of relending them to others who will spend them, they do not ordinarily result in any increase in foreign private holdings of claims on the United States. The decision of a foreigner to add to his holdings would, in general, work in harmony with foreign efforts to tighten credit, rather than in conflict with such efforts. In short, what has particularly worried foreign monetary authorities has been the inflow into their countries of U.S. capital, rather than the outflow of liquid funds from their countries to the United States. Far from deploring the latter, the monetary authorities in several countries (e.g., Germany, the Netherlands, Switzerland, Italy) have often encouraged it as an anti-inflationary measure.

Question 18. The Review Committee proposes to treat privately held dollars abroad primarily as investments. But such dollars yield less than assets in most other currencies, and they appear to be held abroad because of their superior liquidity and wide acceptance as a medium of exchange rather than because of their earning power. Doesn't treating them as investments give a misleading impression of the characteristics of these dollars and the purposes for which they are held?

Answer. There may be a semantic difficulty here. The Committee intended to suggest that flows of foreign private capital are much like flows of U.S. private capital. The word "investment" is no more appropriate or inappropriate in the one case than in the other, and was avoided at most points in the report. The phrase "capital flow" is intended to be as neutral as the phrase "flow of funds" that is used domestically and is applied alike to changes in demand deposits and sales of corporate securities.

The question states that the foreign-owned dollars are held "because of their superior liquidity and wide acceptance." If so, they are unlikely to have been acquired for the purpose of financing a payments deficit, or as a result of official controls, as suggested in question 14 above.

Question 19. The balance sheet position of the United States would be improved if our short-term liabilities could be funded and replaced by long-term debt. But the official settlements concept would not regard it as an improvement in our balance of payments even if all of our liquid liabilities to foreign official monetary authorities were replaced by long-term debt. Isn't this a serious defect in the official settlements concept?

Question 20. The official settlements concept would not show our balance-of-payments position improved if we borrowed foreign currencies from foreign monetary authorities in exchange for long-term debt, but it would show our position to have improved if the borrowing were done from private foreigners, even if we had to pay higher interest than would have been necessary to borrow from their central banks. Does this make sense?

Answer. The Committee was careful to point out (p. 3, and ch. 11) that "distinctions based on the liquidity of liabilities as well as of assets are important." But it argued that they are less important, as an organizing principle in summarizing the payments position, than the distinction between transactions undertaken by the monetary authorities and transactions undertaken by all others.

In the situation postulated in question 19, the official settlements position would show an improvement if the new long-term debt were owed to someone other than monetary authorities, and this seems likely to be the result of a funding operation. Only if the short-term liabilities to foreign monetary authorities were replaced by long-term debt to monetary authorities would there be no change on the official settlements concept. It seems unlikely that foreign monetary authorities would invest any substantial portion of their reserves in really long-term loans to this country or any other.

In answer to question 20, it does seem sensible to regard long-term borrowing from private foreigners as fundamentally more helpful than long-term borrowing from foreign monetary authorities, assuming the latter to be possible at all. The relevance of interest rates to this assessment is not clear.

Question 21. How does the Review Committee propose to distinguish officially held dollars when our statistics are not able to identify the $2 to $3 billion of officially owned reserves which foreign monetary authorities deposit with foreign banks or in foreign branches of U.S. banks?

Answer. As explained in the answer to question 11 above, and on pages 117–118 of the Committee's report, the U.S. balance of payments is a record only of transactions involving U.S. residents. "The fact that obligations of one foreigner to another happen to be denominated in U.S. dollars does not make them U.S. obligations." Thus, there is no reason to expect the U.S. statistics to identify or include the reserves described in this question. Foreign official claims on the United States, on the other hand, are well covered by the present reporting system, as explained on page 72 of the report.

It is, of course, important to know something about dollar-denominated reserves held with foreign banks or branches. As noted in connection with question 11 above, the Euro-dollar market is best studied as an interconnected whole. Official reserves and official settlements are also best studied in this way. Recognizing this, national monetary authorities in major countries have made great progress in exchanging information on their official assets and their liabilities, most recently in connection with "multilateral surveillance" under the Group of Ten. And information from a larger group of countries is gathered and collated by the International Monetary Fund.

It is often wrongly supposed that the $2 or $3 billion of dollars held outside the United States by foreign monetary authorities should be regarded as additional to the assets they hold in the form of direct claims on this country. In fact, dollar funds placed in the Euro-dollar market by one central bank often end up—at the end of a chain of transactions—as a direct claim of another central bank on the United States. If, for example, a South American central bank deposits dollars with a commercial bank in London (as in the case described in question 12 above), that bank may swap the dollars into sterling, selling the dollars to the Bank of England for sterling and covering the exchange risk forward. Then U.S. statistics will show a liability to the Bank of England, and it would be quite wrong to think of the South American dollar claim on London as somehow an additional U.S. liability to a foreign official holder. If the South American central bank later withdraws its dollars from London, official British holdings in the United States will be correspondingly drawn down. It would be impossible in this case for the central banks of both Britain and the South American country to exercise a claim on this country. The two are not additive from the U.S. point of view.

Question 22. If foreign central banks shift their dollar reserves from U.S. to foreign banks, why should we consider that a sign of strength in the dollar while the opposite shift from foreign to U.S. banks is considered a sign of weakness?

Answer. As noted in the answer to question 21 above, a shift by one foreign central bank of dollar funds from United States to foreign banks may set in motion other transactions that increase the claims on the United States of another foreign central bank or banks. If so, there is no net effect on the official settlements deficit, and this seems the appropriate outcome. This case seems likely to be the usual one. It would hardly be profitable for a foreign bank or branch to bid successfully for a deposit previously held in the United States and then turn round and itself make a deposit of these funds in the United States. More commonly the intermediary bank would seek deposits only because it had profitable uses for them, and the relending of the funds would then affect other holdings, including central bank holdings.

If, however, the simple case should ever occur in practice in which a central bank shifts deposits from the United States to a foreign bank, and the foreign bank then redeposits the funds in this country, and nothing else happens, it could be argued that this transaction was not handled very satisfactorily by use of the official settlements concept. There are a large number of other conceivable transactions for which the official settlements concept does not provide the most useful organizing principle. The Review Committee dealt at length in its report with the most important of these. It found that they were not of decisive importance, and that several more important classes of transactions were much better handled analytically by an official settlements classification than by the present "liquidity" classification. The Committee tried to make clear that no single method of summarizing the complex balance of payments situation is wholly satisfactory, and it argued only that the official settlements concept was preferable to other summary concepts.

Question 23. Doesn't the official settlements concept encourage certain types of transactions which give the appearance of improving the balance of payments but which do not affect our true underlying position? For example, it would be possible to induce foreign monetary authorities, through changes in interest rate regulations, to transfer deposits they hold with U.S. banks to the foreign branches of these same banks. The result would be a recorded improvement in our balance of payments, because according to our statistics a liability to a foreign official monetary institution would appear to have been transferred to a private foreign holder.

Isn't it a defect of the official settlements concept that it lends itself to this type of "window dressing"?

Answer. Any classification of international transactions is subject to manipulation, and may give rise to misunderstandings. The type of transaction described in this question is the same one as in question 22, but this time it is induced by official changes in interest rate regulations. It could presumably have been induced by other official actions or inactions—tax changes, general credit policies, forward exchange operations, and so forth.

The Committee was inclined to feel that most policy measures that produce international transfers of foreign funds are to be regarded as genuinely affecting the balance of payments position, and are not to be written off as mere manipulation or "window dressing." But it favored much closer study of such transfers than they have hitherto received, and recognized the special aspects of transfers made in response to official intervention in the forward foreign exchange market.

The present summary classification of international transactions on the liquidity principle would appear subject to at least as many difficulties as the proposed classification. There have been several cases within the past few years when classification of particular items has been in dispute, or when the form of particular transactions has been negotiated with a view to minimizing its impact on the statistical deficit as presently measured. As noted on page 108 of the report, there have been differences of view as to whether nonmarketable medium-term U.S. Government securities represented liquid liabilities. The special U.S. notes issued to the Inter-American Development Bank and to the International Development Association were originally classified as liquid, and later reclassified as nonliquid. Certain balances held with the U.S. Treasury by foreign governments were similarly reclassified. As noted on page 113 of the report, arrangements have been made for international institutions that borrow in the United States to place the proceeds of their U.S. bond issues in long-term time deposits so that the issues would not add to the deficit as now measured.

On balance, the Committee felt that if changes in balances held in the United States by foreign commercial banks are shown separately in the statistical tables, and if due regard is paid in analysis to the fact that such balances are sometimes importantly affected by official actions, then the official settlements classification is less subject to manipulation and to difficult borderline decisions than is the present liquidity classification.

Question 24. How can one tell a monetary authority from other Government agencies abroad? Are reserves always held by central banks or also by Government agencies such as the Treasury in the United States? How can one tell whether foreign exchange held by treasuries in other countries are reserve assets or other assets?

For instance, our Treasury holds large amounts of foreign currencies. Are they included in our reserves? If not, what are the criteria to exclude some, but not others?

Are these criteria also applied to various types of dollar assets held by foreign treasuries?

Answer. It is relatively easy to distinguish a monetary authority from other Government agencies. Reserves are almost always held by central banks, treasuries, or by such specialized reserve-holding agencies as exchange stabilization funds and currency boards.

Not all funds held by treasuries are to be regarded as monetary reserve holdings, but those that are can usually be readily distinguished from those that are not. For example, in the case of the United States, it is clear that large Treasury holdings of inconvertible foreign currencies acquired in connection with the aid program are not held as reserves. Also, relatively small amounts of convertible foreign currencies held as working balances by overseas disbursing officers are not included in U.S. reserve statistics, partly for conceptual reasons but also because it would be impracticable to assemble the data on such scattered holdings promptly every month. These distinctions between reserve holdings and other holdings are already made without difficulty in the case of the U.S. Treasury. They could also be made relatively easily in the case of foreign treasuries.

Some difficult cases might arise. Thus, it may be arguable whether the "Roosa bonds" purchased as an investment by the Swiss Confederation (see pp. 111–112 of the report) represent Swiss reserves or not. Similar doubts may arise in the case of the "Roosa bonds" purchased by the Government of Canada last year in connection with the Columbia River transactions (p. 111 of the report), although in the latter case it seemed clear from Canadian parliamentary discussions that these securities were being formally held outside the reserves purely to suit the convenience of the United States, and were in fact regarded by Canada as equivalent to reserves. It may be that the official purchasing missions of certain foreign countries hold large and fluctuating amounts of foreign exchange that are properly regarded as reserves. But classification problems of this kind seem likely to arise in only a small number of cases, and to be fairly readily resolvable.

The Committee noted (p. 112) that present U.S. data do not distinguish foreign monetary authorities from other foreign official holders. It recommended that some effort be made, perhaps by a sample survey, to see whether changes in total foreign official holdings provide a good approximation of changes in holdings of foreign official monetary institutions.

Question 25. The review Committee recognizes that "Much analytical work still needs to be done on the behavior of those items that are classified differently on the official settlements concept than on the present liquidity concept," but it implies that the official settlements concept should be adopted even before this work is completed. ("Meanwhile, however, adoption of the official settlements concept will provide a better starting point for appraisal of the overall position.")

Wouldn't we do better to do the analytical work first, before we move to a new concept of the deficit?

Answer. The Committee felt that its own investigation of the nature and behavior of foreign private claims on the United States was sufficient to establish that changes in those claims are more usefully regarded as ordinary capital movements than as settlement items, as explained in chapter 9 of its report.

The need for more analytical study of the behavior of foreign private claims arises from two sources. First, because such claims have hitherto been lumped together with official settlements below the line as residual items that do not affect the overall deficit, they have received remarkably little study. Analysts in the Commerce Department and elsewhere have paid close attention to movements of U.S. private capital and their causes and effects, but very little attention to movements of foreign private liquid funds. The Committee hoped that one result of its proposed new classification, with special emphasis on foreign commercial bank claims on this country, would be to encourage study of the behavior of such claims, with resultant better understanding of international flows of funds, the Euro-dollar market, and the U.S. balance of payments.

Secondly, closer study is needed of the particular instances in which foreign central banks have intervened in forward foreign exchange markets for the specific purpose of influencing the foreign balances of commercial banks. The Committee found that such actions had not dominated the changes in foreign commercial bank claims on the United States over any long period, or even in most short periods. Detailed study seems unlikely to affect this main conclusion. Nevertheless, the Committee recognized that official intervention had probably had important effects in particular quarters. It would be very useful to know more precisely what these effects have been.

For example, did official intervention in the forward exchange market for the currency of a particular country at a particular time have large effects on the total foreign exchange holdings of the commercial banks in that country? Did it also have significant effects on the distribution of U.S. liabilities as between those to foreign commercial banks and those to foreign monetary authorities? (As noted in the answer to question 21, the answer to the second of these questions does follow automatically from the answer to the first, since when the commercial banks of one country put funds into the Euro-dollar market, the reserve holdings of some other country are likely to be increased.) It is gratifying to the Committee that debate about its proposals is already stimulating a search for answers to questions of this kind.

O