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THE BALANCE OF PAYMENTS STATISTICS

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STATISTICS

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SUBCOMMITTEE ON ECONOMIC STATISTICS

WEDNESDAY, JUNE 9, 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 1202, New Senate Office Building, Senator William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Javits; Representative Ellsworth.

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

Senator PROXMIRE. This morning we conclude the hearings of the Statistics Subcommittee on the report of the Review Committee for Balance of Payments Statistics. Again we are fortunate in having been able to arrange for testimony by three outstanding witnesses.

Prof. James W. Angell is one of our country's most eminent experts on international finance. His contributions for more than 30 years have enriched the literature in this field. Professor Angell has been associated with Columbia University since 1924.

Our second witness, Mr. Peter Fousek, is assistant vice president of the Federal Reserve Bank of New York. He has served with this bank for 15 years, both in research and foreign operations. He is author of the study, "Foreign Central Banking: The Instruments of Monetary Policy." Although the Federal Reserve Bank of New York has taken no official position on the Review Committee's report, I understand that senior officials of the bank agree with the point of view which Mr. Fousek will present to us.

Our third witness, Prof. Richard H. Holton, now at the University of California at Berkeley, is no stranger in Washington, even though he now resides so far away from us. He was, until January of this year, Assistant Secretary of Commerce for Economic Affairs. While serving in that position he had overall responsibility for the publication of the Commerce Department's analyses and statistical presentations of our balance of payments. He has written numerous works including a study entitled, "The Canadian Economy," which he coauthored.

I am anxious to get as much opportunity to question you gentlemen as I possibly can and I would appreciate it if you confine your remarks to 15 minutes, if possible; if not, 20 minutes. And anything you cannot get on record will certainly be inserted anyway. The complete text of your statement will be put in the record following your testimony.

Professor Angell, will you proceed?

Mr. ANGELL. Thank you.

TESTIMONY OF JAMES W. ANGELL, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY

Mr. ANGELL. Mr. Chairman and members of the subcommittee, it is a great pleasure to me to appear before you today. I have been concerned with the questions here at issue for many years. It is most encouraging to see these questions now receiving such detailed attention from your very distinguished committee.

Let me say at the outset that the report of the Review Committee seems to me an admirable document. It cuts through enormous tangles of confusion with respect to both the actual data and the underlying concepts, and sets out most of the principal problems with remarkable clarity. Its authors are to be congratulated on a first-class piece of work.

The report presents two principal groups of recommendations. One group is at the essentially technical level. It consists of many detailed proposals for improving the collection, analysis, and control of the raw balance of payments statistics. Here I think few people could find serious grounds for disagreement with the report, and I shall not offer any elaborations of my own.

In particular, I should like to support strongly the recommendation that the Bureau of the Budget shall take active responsibility for coordinating the work of the various agencies involved. Only the Bureau has the power to enforce such coordination.

I also strongly urge that additional funds to be available, and I shall make two additional suggestions in this area later, both to increase the coverage of the raw data—which in some areas is now lamentably thin and even haphazard—and to improve the analytical techniques used.

The second group of recommendations in the report is at a different level, and has given rise to a good deal of debate. These recommendations deal with the conceptual problem, which has bedeviled economists for many decades, of what one really means by the notion of a deficit or a surplus in a country's international payments, and of how to measure them.

In one sense, of course, as you all know well, the question is empty. The nature of the recordkeeping involved in the international accounts is such that the total of a country's international credit items of all sorts, for any given period, always equals the total of its international debit items for the same period.

But for a variety of obvious economic and other reasons, special importance is usually attached to certain items in the aggregate array. These are the so-called balancing items.

The problem is, Which items belong in this balancing category? A net excess of credits with respect to the balancing items is regarded as proof that the country's international payments position as a whole is in deficit. Moreover, the size of the net excess of these balancing credits is taken as the measure of the deficit. If there is a net excess of balancing-item debits, on the other hand, this is regarded as proof that the overall position is in surplus. All this is, of course, entirely familiar.

But which items belong in this "balancing" category? This is where the fighting starts, because opinions differ.

On this crucial question, the report of the Review Committee and the position of the Department of Commerce are sharply opposed. Both agree with the commonsense view that changes in monetary reserves are a balancing item, and that a gain or loss of such reserves indicates an overall payments surplus or deficit, other things equal.

But the report is strongly critical of the much broader definition of and measurement of the overall payments surplus or deficit, which has been used for so many years by the Department. This is the so-called liquidity measure, which includes a good deal more than monetary reserves alone. The report proposes to replace this measure by a measure of what it calls official settlements or reserve transactions, a much narrower concept, and to use only this measure.

The question is, Which is right?

I have not been privileged to hear the previous testimony before this committee, but I should be prepared to find that at least some of the other witnesses have much the same opinion that I do.

On my view, both the recommendations made in the report and the tabular presentations now prepared by the Department of Commerce are incomplete. I think the report misjudges the importance of net short-term private capital movements as a measure of the current international deficit or surplus, and also underestimates their potential effects on our own official monetary reserves.

On the other hand, the Department of Commerce does count the movements of short-term private foreign capital as part of its measurement of the total deficit. But it does *not* present any one single figure which summarizes the net change in reserve transactions, despite their obviously enormous significance. This latter failure, likewise, seems to me a serious defect. I also have less important objections to the treatment of various other items, both by Commerce and in the report. These objections are spelled out in my written statement.

The main issue between Commerce and the report, to repeat, is hence the treatment of short-term private capital movements. The issue can be presented very simply.

Suppose that in a particular year, total U.S. international payments for private imports of foreign goods and services exceeded the comparable payments due to us by $3 billion.

Suppose also that in that year we paid $1 billion of our gold reserves to foreign monetary institutions, and that foreign private holdings of deposits in U.S. commercial banks increased by $2 billion.

Finally, suppose that the net balance of all other types of transactions was zero. Then how large was our international payments deficit for that year?

The report proposes to measure the deficit, in this case, solely by our loss of monetary reserves. In the view of the report, the deficit was only $1 billion.

The importation of foreign short-term private capital—here the purchase of U.S. bank deposits by private foreigners—is hence treated on precisely the same footing as a private foreign purchase of U.S. long-term securities, or of U.S. wheat. It is not counted as a settlement item, and is not regarded as part of the measure of our total international deficit. It is put "above the line."

The Department of Commerce view is different. Commerce, too, counts the loss of monetary reserves as part of the measure of the deficit, of course. But Commerce also includes the importation of short-term private capital. For Commerce, the deficit was $3 billion, not $1 billion.

Again, which is right, Commerce or the report?

The answer seems to me simple and unequivocal, at least in broad terms. To illustrate, take the preceding example and modify it slightly. Suppose that in a particular year our total payments for private imports of foreign goods and services again exceeded the comparable payments due to us by $3 billion.

Suppose also, however, that this time we neither gained nor lost gold or any other monetary reserve item. Finally, suppose that the net balance of all other types of transactions was likewise zero, except for short-term private capital movements.

It is then obvious that there was a net deficit in the total of our international transactions on everything other than short-term private capital accounts. But it is also obvious that this deficit must have been offset by an increase in the foreign private ownership of titles to U.S. private demand or short-term liabilities, such as bank deposits or open accounts on the books of our important firms. No other form of offset was possible. Moreover, in this case the increase in our short-term private liabilities is precisely the measure of the deficit.

The report takes a different view (p. 114f.), but I do not find the argument persuasive. The report counts a change in short-term dollar liabilities held by a foreign central bank, for example, as one measure of our international deficit or surplus, and puts it "below the line."

An increase in short-term dollar liabilities held by private foreigners, however, is not treated in this way. Instead, as already remarked, the report puts it in the same general category as foreign private purchases of U.S. securities or wheat. It is not regarded as a measure of our current deficit.

But this procedure can produce misleading results. If a foreign private holder of short-term dollars, for example, now sells the dollars to his own central bank, the report regards this increase in our official liabilities as showing that there has been an increase in the U.S. payments deficit.

Yet nothing else has happened. There has been no increase in U.S. imports, no decrease in U.S. exports, and nothing else has taken place which in itself either affects, or has arisen out of, the economy or the transactions of the United States as such. All that has happened is that there has been a shift in the foreign ownership of some of our short-term liabilities, from foreign private hands in the hands of a foreign central bank, with no change in the total volume of these liabilities themselves.

It does not seem to me realistic to say that this mere shift in the foreign ownership of the liabilities indicates that there is now a deficit in our international accounts, when the original private acquisition of the same liabilities was not so treated. On my view, it was the latter original acquisition that indicated and measured the real deficit, in this case.

The treatment of net short-term private capital movements as a measure of the international payments surplus or deficit can be objected to, of course, on other grounds.

It can be argued, quite correctly, that substantial and perhaps large parts of these capital movements are really autonomous, in the sense that the owners of the capital really do want to build up and maintain liquid balances in the other country—often for long periods. It must be acknowledged that such movements of what is in form short-term capital are, in actuality, closely analogous to movements of securities or wheat, as the report contends. These types of movements of short-term capital are not frequently reversed. They enter the balance of payments on what is commonly, within quite substantial periods, a once-for-all basis. They do not exhibit frequent fluctuations in first one direction and then the other.

On the other hand, another and perhaps the larger part of these short-term private capital movements usually has a different motivation. It can be described as "accommodating," in the sense that from the overall national point of view of the creditor country, no other more acceptable means of settling the obligations due was available.

This type of short-term private capital is not exported with the intention of keeping it abroad for any great length of time. It is exported, rather, in response to current money market, security market, and exchange rate situations, which themselves reflect, in part, the current position of the balance of payments. When a change in the balance of payments on other accounts subsequently takes place, and when these latter more immediate causal situations hence also change, the short-term capital itself is likely to return to its home. It is relatively volatile.

It is not possible to separate these two types of capital movements statistically, of course. But the importance of the second type, and especially of its short-run fluctuations, is great enough so that I think it is more realistic to treat the whole of the changes in these short-term private liabilities as one measure of the overall payments surplus or deficit. Indeed, no net international movements of short-term private capital can take place at all, unless the total of all of the other items in the balance of payments is in surplus or in deficit.

A second major reason for including changes in net short-term private liabilities in the measurement of international deficits or surpluses is the fact that the size of these liabilities is one important index—though not the only one—of the potential pressures on our international monetary reserves.

Any adverse circumstance, including an unduly large growth of these liabilities themselves, could exert such pressures with little or no warning. For example, a growing belief that a stock market crash is coming, or that the dollar will be devalued. And wide swings can result, as is familiar, if exporters and importers merely speed up or delay their payments and receipts.

One leading New York banker has estimated privately that as much as 40 to 50 percent of the private foreign deposits now in U.S. commercial banks could be withdrawn in a period of only a month or two, though this is, of course, hardly likely to happen.

It is true that a withdrawal of dollar deposits owned by private foreigners, for example, is not itself a reduction of our own monetary reserves. Private foreigners cannot buy monetary gold here. But such withdrawals put pressure on our exchange rates, and may compel our monetary authorities to intervene in support. The end effect may hence be much the same.

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Or the private foreigner may sell his dollar deposits to his own central bank, as already noted. Foreign monetary policy may at times either encourage or even require such sales (report, p. 115). In the latter event, the dollar liabilities which were originally privately owned suddenly become a direct official claim on our own monetary reserves—though nothing has changed in the United States.

With respect to the whole range of issues just considered, and subject to qualifications set out in my written statement, I therefore reach the following general conclusions:

First, as the report itself suggests (p. 2), I do not believe that any one figure can serve all the purposes, for which a measurement of the balance of payments surplus or deficit can and should be used.

Second, I think that the most realistic and most useful definition and measurement of the surplus or deficit must include both the "official" reserve transactions measure proposed by the report, and also the net movements of liquid private capital. The latter figure must incorporate, of course, changes in U.S. liquid assets owned abroad.

Third, I therefore propose that the main balance of payments table, published by Commerce, shall present not one but three balance items, on adjacent lines, as follows:

1. Net liquid private capital movements.
2. Net official reserve transactions.
3. The total surplus or deficit, which is the algebraic sum of the first two.

This form or presentation is simple and unambiguous, sets out the main actual and potential strategic factors in a clear way, and allows the user of the table to concentrate on whichever balance figure best suits his particular requirements.

A more detailed form of the proposed general table is given in my written statement. The total surplus or deficit which I have proposed in line 3 comes much closer, since 1958, to the deficit computed by Commerce than to that in the report.

For lack of time here, I shall not comment on the numerous other questions raised by the report. The more important ones, discussed briefly in my written statement, have to do with the errors and omissions item; the entries for the so-called special Government transactions; the treatment of nonconvertible U.S. Government securities purchased abroad (which I think should all be placed "above the line"); the method of reporting U.S. Government transactions in general; and the concept of the so-called "basic" balance.

In my written statement I have also offered some suggestions for sampling studies of, first, the volume of foreign exchange commitments outstanding at different consecutive times; and, second, of the relation between the dates of export and import shipments of physical goods, on the one hand, and on the other, the dates of the actual payments for these shipments.

The two sets of dates may be widely divergent, and this divergence can have very substantial effects on the accuracy of the balance of payments computations themselves.

Thank you. If you have any questions——

Senator Proxmire. Thank you very much. We will have our questions and answers following the testimony of the other two witnesses.

PREPARED STATEMENT OF JAMES W. ANGELL, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY, NEW YORK, N.Y.

I. INTRODUCTION

The report of the Review Committee for Balance of Payments Statistics is at once the most exhaustive and the most valuable investigation of the subject that has been made to date. It cuts through enormous tangles of confusion with respect to both data and underlying concepts, and sets out most of the main issues with admirable clarity. Its authors are to be congratulated on a first-class piece of work. If anyone wishes to question either the Committee's proposals or the Department of Commerce formulations, or any other framework of ideas, it is now far easier than ever before to be precise as to what the points at issue really are.

The report makes many excellent proposals, with which few would disagree, for improving the collection and analysis of the complex data that are summarized in the quarterly and annual statements of the U.S. balance of payments prepared by the Department of Commerce. On these proposals, I have little to say.

The main burden of the conclusions of the report, however, turns on the definition and measurement of the surplus or the deficit, as the case may be, in the balance of payments itself. The report is strongly critical of the measurement used for so many years by Commerce, the so-called liquidity measurement, and proposes to replace it by a measurement of what it calls official settlements or reserve transactions. Both concepts are thoroughly familiar to the subcommittee, and need not be defined in more detail here. The differences between the two concepts with respect to the treatment of specific major items are spelled out in table 9.1 of the report.

On my view, however, both the report and the Department of Commerce positions are incomplete. The report does not attach sufficient importance to the movements of private liquid capital, and hence to changes in the overall liquidity position; the Department presentations make it difficult to sort out and appraise the changes in official transactions; and other less important changes should, I think, be made in both measures. Moreover, the Government-reported estimates of the balance of payments surpluses or deficits are used for many different purposes, and I do not believe that a single figure can serve all these purposes adequately. (And see a statement in similar vein in the report, p. 2.) Indeed, using either the report or the Commerce figure alone, or any other one figure, can lead to serious mistakes in judgment and action.

II. TREATMENT OF PRIVATE LIQUID CAPITAL MOVEMENTS

The principal difference between the present Commerce concept and measurement of the balance of payments surplus or deficit and those proposed by the report lies in the treatment of movements of private liquid capital. There are also less important differences with respect to special Government transactions, and also foreign holdings of U.S. Government bonds and notes. The two agree on the treatment of the errors and omissions item, but some questions about this will be suggested below. In the present section, we shall consider only private liquid capital.

At the outset, it must be stressed that there is a serious ambiguity of terminology here. This is the ambiguity over the notions of short-term and of liquid capital movements. The "basic transactions" concept described in the report (p. 105) makes no real distinction at all. The Commerce tables use both terms, apparently sometimes interchangeably and sometimes not, without ever sharply defining the entirely legitimate distinction between them. The report talks chiefly about liquid capital movements alone, and uses this concept exclusively in defining an international payments surplus or deficit. In what follows, in connection with my own definition and measurement of a payments surplus or deficit, I shall use only the concept of movements of liquid capital, so called. By this I shall mean official and private bank deposits, whether demand or time; certificates of deposit issued by banks; bills of foreign exchange; and open account or other short-term assets of or liabilities to foreigners on the books of commercial, industrial, or financial firms. All other short-term capital items will be treated as analogous to investment transactions, and placed "above the line" (also see sec. II.2, below).

The main issue with respect to private liquid capital is simple. Suppose, for example, that in a particular year total U.S. international payments for private imports of foreign goods and services, private long-term investment, and U.S.

Government foreign loans, other aid and military and other expenditures, exceed the comparable payments due to us by $3 billion. Assume all other types of transactions, except changes in our reserves and in foreign private and official monetary institutions' holdings of U.S. liquid liabilities, to be zero. Suppose also that we then pay $1 billion in gold reserves to foreign institutions; and that foreign private holdings of deposits in U.S. commercial banks increase by $2 billion. That is, we have imported $2 billion of foreign private liquid capital. Our balance of payments as a whole is hence in equilibrium: total receipts equal total payments.

But how large was our international deficit? The report proposes to measure it, in this case, solely by our loss of monetary reserves: the deficit was only $1 billion. The importation of private liquid capital—the purchase of U.S. bank deposits by private foreigners—is hence treated on precisely the same footing as a private foreign purchase of U.S. long-term securities or of U.S. wheat.

The Department of Commerce concept and measurement is different. Commerce, too, counts the loss of monetary reserves as part of the measure of the deficit, of course. But it also includes the importation of private liquid capital. For Commerce, the deficit was $3 billion, not $1 billion. The Commerce defense for this procedure, amply spelled out in the report (e.g., p. 107f.), is that the international liquidity of the United States was reduced both by the loss of monetary reserves and, equally, by the increase in our liquid liabilities to private foreigners. (By a curious asymmetry, however, Commerce refuses to count an increase in foreign liquid liabilities to private Americans as an increase in our international liquidity. This practice will be commented on again later.)

This is, Commerce treats the increase in our liquid liabilities to private foreigners as one means by which our overall deficit on other accounts was paid—as a settlement item—and hence places it "below the line." The report treats the increase as being comparable to an export of U.S. merchandise, services, or long-term securities, "above the line"; and hence as simply one component in that total array of payments and receipts, whose net deficit or surplus must be settled by official reserve and other transactions.

Which is right?

The answer seems to me simple and unequivocal, as already stated. Both measures of the international deficit (or surplus) must be computed and published (with certain modifications, suggested below), because while each is essential, neither is alone adequate; neither can alone meet all the requirements.

The official settlements or reserve transactions measure advocated by the report, so far as it goes, requires no defense. Knowledge of its size and changes is obviously essential to the formulation of domestic and international monetary and fiscal policy, and in many other policy areas as well. On the other hand, however, the monetary authorities do not have to wait for the quarterly publication of the balance of payments statement to learn what the figure is: they already know, because they supply the data themselves.[1] Its main value is hence to keep the Members of Congress and the business and banking community informed on out international reserve position, and alert to its main trends.

The Commerce measure, which includes changes in liquid liabilities to private foreigners, is however also essential. This is true for two principal reasons. The first is the fact that on my view the most accurate and realistic definition of a country's overall international deficit (or surplus) is the definition that includes net changes in liquid liabilities to private foreigners. The second is the tremendous significance of changes in the liquid liabilities owned by private foreigners as measures of the potential pressure on our international monetary reserves. The considerations involved are as follows.

1. *Liquid net private capital movements as a measure of the "true" deficit (or surplus)*.—Assume that the total of the payments the United States owes abroad for private imports of foreign merchandise, services, and securities again exceeds the total of U.S. receipts for similar transactions in a given year by $3 billion. Also assume that the change in U.S. monetary reserves in the year is zero, and that all other possible types of transactions are likewise zero net. Then the intrinsic nature of the foreign-exchange-market relations between the United States and any other money-using capitalist economy insures that the difference between payments and receipts, here a "deficit," will be "settled" by the transfer

[1] But even the reserve transactions measure can contain pitfalls. Thus suppose that the New York Federal Reserve Bank holds dollar deposits to the credit of a foreign central bank; and suppose that the latter bank, without informing the Reserve bank, sells the deposits to a private buyer—perhaps in a third country. As long as the buyer merely holds or again sells the deposits, without their being drawn on, U.S. official liquid liabilities abroad may clearly exceed total foreign official dollar claims. The converse case can also arise, of course, as shown below.

to foreign private ownership of titles to U.S. commercial bank deposits or to other comparable U.S. liquid liabilities—for example, open credits on the books of importing firms. No other form of settlement is possible.

There is nothing in this which is peculiar to international transactions, of course; precisely the same thing is true of the payments and receipts of any domestic business firm for a given period. This is hence the basic reason for regarding changes in our liquid liabilities as a measure of part of our total international deficit or surplus; and in the case just cited, the sole measure. In this case the change was the means by which the whole deficit on other accounts was settled, and our international payments as a whole thus kept in accounting equilibrium. The item therefore belongs "below the line."

It is true that substantial and perhaps large parts of the international movements of liquid private capital are really "autonomous," to use the older phrasing, in the sense that the owners of the capital really do want to build up and maintain liquid balances in the other country—often for long periods. Examples are the establishment of commercial or financial working balances, or of minimum balances against loans and lines of credit. Such movements of what is in form liquid capital are in fact analogous to movements of investment funds. They are not frequently reversed, and do not exhibit frequent fluctuations. They enter the balance of payments as what is commonly, within substantial periods, a once-for-all credit or debit item.

But another and perhaps larger part of these liquid private capital movements has a different motivation. This capital is not "exported" with the intention of keeping it abroad for any great length of time. It is exported in response to current money-market, security-market or exchange-rate situations and prospects, which themselves reflect in part the current position of the balance of payments; or it may be "exported" simply in the form of open-account liabilities on the books of a merchandise importer; or it may take some other form, as in the case of the claims underlying the Euro-dollar market. This capital is relatively volatile; any of a thousand developments may cause it to flee home—and then perhaps return again later.

It is not now possible to separate these two types of liquid private capital movements statistically, of course. But the importance of the second type, and especially of its fluctuations, is great enough so that I think it is more realistic to treat changes in the total of the liquid private liabilities as one measure of the overall payments surplus or deficit. Only a part of them, and that the less volatile or changeable part, is really analogous to movements of investment capital. Moreover, it is self-evident that no net international movement of liquid private capital can take place at all, unless the total of all the other items in the current balance of payments is in surplus or deficit. The capital movement is then the precise measure of the surplus or deficit itself.

The questions here at issue are discussed at length in the report (p. 114f.), and a different conclusion is reached, but I do not find the argument persuasive. The report counts an increase in liquid dollar liabilities held by a foreign central bank as an indication that there has been an increase in the U.S. payments deficit (or a decrease in the U.S. surplus). But it does not so count an increase in such liabilities if they are held by a private foreigner. And so conversely for decreases in liquid liabilities.

But this can produce misleading results. If a foreign private holder of liquid dollars, for example, now sells the dollars to his own central bank, the report contends that this increase in U.S. "official" liabilities shows that there has been an increase in the U.S. payments deficit, other things of course equal. Yet nothing else has happened. There has been no increase in U.S. imports, no decrease in U.S. exports, and nothing else has taken place which in itself either affects, or has arisen out of, the economy or the transactions of the United States as such. There has been a shift in the ownership of liquid dollar liabilities from one foreign holder to another, but the total volume of these liabilities themselves has not changed, and nothing else has happened. On my view, it is far more realistic and useful to hold that it was the original acquisition of the liabilities by the private foreign holder that indicated an increase in the U.S. deficit, not their transfer to the ownership of a foreign central bank. The report's proposed procedure here hence seems to me inaccurate and even misleading.

In the example above, it was assumed that the change in U.S. monetary reserves in the year was zero. In most actual cases, however, such changes do occur, and are obviously another method of "settling" an international deficit or surplus. Pro tanto, of course, they are also a measure of the deficit or surplus. The combined total measure of an international deficit or surplus proposed here is hence the algebraic sum of changes in monetary reserves as defined in the report, plus net changes in liquid liabilities to private foreigners (net, that is, of changes in foreign liquid liabilities to private Americans, as explained later). The treatment of "special government transactions" will be considered subsequently.

2. *Liquid net private capital movements as a measure of the potential pressure on reserves.*—A second reason for including changes in our net liquid liabilities to private foreigners in the measure of our international deficits or surpluses is the fact that the size of these liabilities is one measure, though not the only one and not perfect, of the potential pressure on our international reserves which could develop with little warning, if circumstances turned adverse. And changes in the size of the net liabilities are a measure of changes in the potential pressure. Any monetary official who simply ignored the existence of these liabilities, or refused to take them into account in his own calculations (and I am sure none does), should be dismissed.

In the "normal" course of events, when there are no serious business, monetary, or political threats to general confidence, the average total volume of most of these liquid liabilities is fairly stable, as the statistics show; indeed, in the last decade or more they have grown at a remarkably even rate. But any substantial impairment of confidence could change this picture drastically: for example, a growing belief that the dollar will be devalued, or that a stock market crash impends, or that war is likely. Some deposits would be withdrawn outright; in other cases, the foreign holders would simply fail to replenish working balances when drawn down. And wide swings can result, as is familiar, if exporters and importers merely speed up or delay their current receipts and payments. One leading New York banker has estimated privately that as much as 40 to 50 percent of the private foreign deposits in U.S. commercial banks could be withdrawn in a period of only a month or two, though this is hardly likely to happen at present.

Of course, the withdrawal of deposits owned by private foreigners is not itself a reduction of our own monetary reserves, since private foreigners cannot buy monetary gold here. But the withdrawal puts pressure on our exchange rates, and may require that our monetary authorities intervene to support them. The end effect may hence be much the same—a reduction in our own monetary reserves. Or the private foreigner may sell his dollar deposits to his own central bank, as remarked earlier—a sale which foreign monetary policy may at times either encourage or even virtually require (report, p. 115). In that event, the dollar liabilities then become a direct claim on our reserves. And there are various other possibilities.

Finally, so-called liquid liabilities are only the most liquid of a wide array of U.S. assets owned by private foreigners. Many of these, such as U.S. Government securities, and prime corporate bonds, stocks and notes, are nearly as "liquid" as bank deposits. They can be converted into cash on very short notice, and they, too, are hence a potential threat to our international liquidity, though at one remove. As a practical matter, of course, most of these assets were bought for longer term investment purposes, but some are essentially speculative holdings and hence volatile. It is obviously impossible to separate out this latter class of assets statistically, however, and it would be silly to go to the other extreme and treat all foreign investment in the United States as a balancing item. I shall hence propose a compromise position, and merely regard liquid U.S. liabilities owned by private foreigners as a reasonable proxy for the more "volatile" portion of these assets.

There is also no way, of course, of estimating the size of the pressure on our monetary reserves which would develop if a serious flight from the dollar by Americans began to appear.

3. *Conclusion.*—The upshot of the preceding analysis is now clear. Both of the two measures of the international deficit or surplus should be compiled and published, though with certain modifications in each. The "reserve transactions" measure proposed by the report (which incidentally cannot be extracted easily from the present Commerce tables) is obviously essential, but it is limited in scope, does not tell anything about the potential pressure on monetary reserves, and on my view does not present the "true" deficit or surplus. The measure used by Commerce, however, is also obviously essential. As I shall propose to modity it, it is roughly the algebraic sum of the report's "reserve transactions" plus net movements of liquid private capital (that is, the net total of charges in U.S. private liquid liabilities and comparable U.S. liquid assets abroad). This sum gives both an accurate picture of the "true" deficit or surplus and, with respect

to private liquid capital, a fairly good measure of changes in the potential pressures on actual monetary reserves. A summary proposed from for the balance of payment as a whole will be presented later. In conformity with the argument above, the main entries "below the line" will be substantially as follows:

1. Total net private liquid liabilities.
2. U.S. official reserve transactions.
3. Total payments deficit or surplus (the algebraic sum of 1 + 2).

This general form of presentation is simple and unambiguous. It sets out the main actual and potential strategic factors in a clear way. It allows the user of the table to concentrate on whichever balance figure best suits his particular requirements, but also calls his attention to the other important elements in the total situation.

III. OTHER CONTROVERSIAL ITEMS AND CONCEPTS

Certain other problems of treatment or concept have also given rise to substantial discussion.

1. *The errors and omissions item.*—Two things are especially striking sbout this item. One is the fact that it is often so large; the other, that it does not seem to behave wholly randomly, but rather shows continued net receipts or (in the recent period) continued net payments, for a number of years at a time. The report associates usually high values of the item with periods of international disturbance (p. 86f.).

This is a net and not a gross item. Hence if it were due primarily to errors and omissions in the collection and analysis of the original data on trade and service accounts, one would expect it either to show a continued bias in one direction, or to alternate fairly frequently between net receipts and net payments. This does not happen. The inference must therefore be that it is connected chiefly with private capital flows. It is entirely likely that in recent years, for example, substantial portions of the proceeds of our merchandise exports have not been brought home, but have been used in one way or another to build up the rapidly expanding working balances and plant investment of American firms operating abroad (many of which are also exporters of U.S. goods); or to purchase foreign securities; or to provide part of the base for the Euro-dollar market. Many of these operations could easily escape the present balance of payments reporting apparatus. On this view, if the expected profitability of direct investment abroad declines, we should see a corresponding change in the errors and omissions item.

So far as the item represents unreported movements of what is really liquid capital, however, it raises another question. Should it be put "above the line," as both the report and Commerce now do; or should it be treated as a balancing item, as in the older "basic" transactions concept (report, table 9.2)? If it is chiefly liquid capital, then in the Commerce presentation too it should be put "below the line." Any clear answer must wait on more information. Meanwhile, one can only support the report's urgent call for further improvements in the underlying data and their analysis.

2. *Special Government transactions.*—On my view, this entry (see report, table 9.2 and 9.3) ought to be abolished, and its components shown separately in the appropriate places. It consists of three subitems, all of which should go "above the line." Advance repayments of U.S. Government loans and sales of U.S. Government nonconvertible securities belong essentially in the investment accounts (the case for putting nonconvertible securities in the investment category rather than in reserve transactions, as the report does, will be spelled out in connection with the new form proposed below). And there is surely no reason for treating advances on military exports as a special item. It is merely an addition to current proceeds from such exports, and might even be relegated to a footnote.

3. *The "basic" transactions concept.*—This concept (report, p. 105) has great usefulness. Its value, however, lies chiefly in the picture it gives (though not too accurately) of the general longer run impact of American productivity and capital formation on the rest of the world. The "basic" balance is not a very good guide to monetary policy, or to the current problems of adjusting to deficits or surpluses in our balance of payments—partly because it includes errors and omissions as a balancing item. It should hence appear as a memorandum item, but not as an integral part of the regular payments presentation.

IV. OTHER DEFECTS OF THE PRESENT COMMERCE PAYMENTS PRESENTATION

The balance of payments data now published for the United States are at once more detailed and more comprehensive than those available for any other country, and the Department of Commerce staff responsible for their preparation deserves great credit for their pioneering work. At the same time, however, it is fair to say that the tabular presentations are not easy to use, despite a number of recent improvements. The three main tables in the quarterly presentations are drawn up in formats that are structurally different; some of the entries in one table do not correspond to what seem at first glance to be similar items in other tables; and in general, it is unnecessarily difficult to put together a simple picture of the main factors and relations involved.

A few examples, some almost trivial, will suffice to illustrate these points. Thus in the "Survey of Current Business" presentation for March 1965, table 1 begins with debit items, tables 2 and 3 with credit items. The locations and breakdowns of capital transactions are different in each of these three tables, as are those of Government transactions. The various kinds of "balance" items are not directly comparable as between the three tables. The heading of table 1 seems to exclude changes in official monetary assets and liquid liabilities, but these items appear at the bottom of the table, and their treatment in tables 2 and 3 is different. Military grants seem to be excluded throughout, but they surely have a substantial impact on the American economy if not on the foreign exchange markets. Table 4 is interesting, but is not easily tied in to the other tables.

The tables also present an asymmetrical treatment of private liquid capital movements. Increases in U.S. liabilities of this sort are regarded as a "settlement" item and are placed "below the line," but increases in comparable U.S. assets abroad are not; they are treated like imports of foreign investment funds. Perhaps neither private liabilities nor assets of this sort should be put "below the line," though the opposite conclusion was reached above (sec. II.1 and 3). But in any event, the treatment should be consistent.

The tables also fail to give any one figure that corresponds to the net Reserve transactions figure of the report. In view of the great importance of the latter figure or some equivalent, this can only be regarded as a real defect.

Finally, I find it difficult to discover from these tables what Commerce thinks our international deficit (or surplus) really is. Various alternatives are presented, but there is no clear indication as to which one is regarded as either the "best" measure, or even merely the best measure for some particular specified purpose. Thus compare the differing entries at the bottom of the three tables. (But interestingly enough, such a figure is suggested in the short summary on page S-2 of the March 1965 presentation—though in two versions.) This obscurity should obviously be cleared up.

V. OTHER RECOMMENDATIONS

1. *Improvement of the statistics.*—The report makes extensive and persuasive recommendations for improving the collection, analysis, and control of our balance of payments statistics, and as stated earlier, I think few could find grounds for serious disagreement with them. I support especially the proposal that the Bureau of the Budget take active and evidently necessary responsibility for insuring that the work of all the relevant Government agencies involved be closely coordinated, so that the concepts, procedures, and forms of presentation shall be mutually consistent. I also urge that additional funds be made available, both to increase the coverage of the raw data—now thin and even haphazard in some areas—and to improve the analytical techniques used. Finally, to help clarify the debate over the definition of the payments deficit and surplus concept, I urge that a sample study be made of the motives for holding private liquid balances abroad—both those held by foreigners here, and those held by Americans in other countries (and see sec. II.1, above).

2. *Timing of transactions versus that of payments.*—Especially with respect to merchandise trade, the dates when actual shipments are made may differ widely from the dates when payments are remitted. The payments may precede, coincide with or follow the shipments, depending on prevailing trade practices and the general outlook. In many transactions credit is extended for 6 to 12 months, sometimes for several years. The balance of payments data published by the Department of Commerce are based primarily or solely on dates of shipment of the actual goods, for exports, or of arrival on dock for imports. Yet it is the payments that affect our international financial position, not the physical move-

ment of goods. Comparable though less serious problems can also arise with respect to the flotation of foreign securities here, and doubtless for other items.

I therefore suggest that a substantial sampling study be made, covering a number of years in the past as well as currently, to discover what the facts here really are. It would be particularly important to find out whether the patterns of payment leads and lags shift substantially, and if so under what circumstances.

3. *Forward exchange commitments.*—As just remarked, a large proportion of the transactions in private merchandise trade provide for payment at a future date. Whenever the commercial contract calls for the payment or receipt of a foreign currency at a future date, the usual practice is, of course, to cover the prospective payment or receipt of the foreign currency by a forward purchase or sale of the currency, in order to avoid the exchange risk. The same thing is true of a variety of other types of international transactions. When there is private speculation or official intervention in the exchange markets, however, purchases or sales of forward exchange take place which are not offset by current sales or purchases of spot exchange. When these forward contracts mature they will, unless renewed, give rise to a demand for or a supply of the foreign currency at spot. Such uncovered demand or supply will create pressure, adverse or favorable as the case may be, on the then-current spot exchange rates and on the general balance of payments position of the originating country.

A guide to the current direction of these pressures is provided by the current relation between spot and forward rates. This relation tells little or nothing, however, about the absolute magnitudes of the forward commitments. It should be extremely helpful to the monetary authorities to know these magnitudes. In a world of complete information, comparison of the commercial commitments to pay or receive foreign currencies spot in the future, which exporters, importers, and others have currently outstanding, with the totals of outstanding contracts to buy or sell the same currencies forward would provide a precise measurement of one type of pressure on the balance of payments which will develop, other things equal, at definitive dates in the future.

Information on by far the largest part of the total volume both of commercial commitments to pay or receive foreign currencies at spot in the future, and of forward contracts to sell or buy, is easily available to the big foreign exchange banks. Without trying to spell out the details here, I therefore urge that sample studies be made to determine the feasibility of collecting such information, and its probable usefulness. (But obviously such information could not be published on a current basis, because of the effects on speculative and other markets.)

Of course this is only half the story, since foreigners likewise buy and sell dollars forward. Foreign central banks, however, have or could obtain a good deal of information on such transactions. As cooperation among the leading central banks increases, it may hence be possible to develop a continuous and mutually advantageous exchange of such information.

4. *Reporting governmental transactions.*—The various types of transactions conducted by the Government which are relevant for balance of payments purposes are now scattered all through the tables prepared by Commerce. Even the present basic table 1 contains more than a dozen Government items. It would be most helpful for users of balance of payments statistics, and indeed for the public at large as well, to present in addition a summary of the totals of all relevant Government transactions—including loans, grants, purchases and sales, military operations so far as genuine security considerations permit, and everything else (except, of course, transactions by our official monetary institutions). These data could be given either in a memorandum attached to the general payments statement, or in a small separate table. The general format should be simple, as follows:

	Credits	Debits	Balance
1. Total foreign transactions			
2. Requiring purchases or sales of foreign currencies			

It is the second line, of course, which is important for balance of payments purposes, but the first line is a measure of the impact of our Government's operations on foreign economies.

VI. SUMMARY

The principal conclusions and recommendations reached above can now be summarized.

1. The most realistic and most useful definition and measurement of the balance of payments surplus or deficit must include both "official" Reserve transactions and the net movement of liquid private capital. The total or aggregate payments surplus or deficit is the algebraic sum of the two. To this extent, I differ with the findings of the report, and am more nearly in agreement with the general position taken by Commerce (though with a number of modifications).

2. The liquid private capital figure is further valuable because it is an important though incomplete measure of the potential future pressure on official monetary reserves themselves.

3. The "official" Reserve transactions figure, not now presented as such in the Commerce tables, is also obviously essential, however.

4. I therefore propose that at the end of the main payments table, three balance figures be presented, on adjacent lines, for: (i) Net private liquid liabilities; (ii) official reserve transactions; and, (iii) the total payments surplus or deficit (the algebraic sum of the first two). Each figure is an essential part of the overall picture, and putting them together in this way enormously clarifies the picture itself. The user of the tables can then see at a glance what the main strategic factors are.

5. Other specific recommendations were also made with respect to the treatment of certain items proposed in the report, especially of the so-called special Government transactions. None of these should be included among the balance items just listed, nor should any other transactions in nonconvertible U.S. Government securities. A number of other suggestions were likewise made for improving the presentation in the Commerce tables.

6. I strongly support the recommendation of the report that active responsibility for coordinating the work of the several Government agencies concerned, with respect to the collection and analysis of the original statistics and the enforcement of consistency of the basic concepts used, be assumed by the Bureau of the Budget. It also seems essential that additional funds be made available.

7. I also urge that sample studies be made of the relation between the dates of actual commercial transactions (for example, the receipt of merchandise imports) and the dates of the corresponding payments; the dates may be widely different. Only the payments are really relevant to the balance of payments computations, and substantial discrepancies in the dates can produce large errors in these computations. Sample studies should also be made of the volume of forward exchange contracts outstanding, since these can be a highly significant guide to possible future pressures on the spot exchange rates and on monetary reserves when the contracts mature.

8. Government transactions with other countries are scattered in various places in both the present Commerce tables and (though to a lesser extent) in the proposed report. They should also be summarized (excluding transactions with official monetary institutions) to show total Government credits and debits, and also the much smaller totals requiring the purchase or sale of foreign currencies.

APPENDIX

PROPOSED GENERAL FORM OF STATEMENT OF U.S. BALANCE OF PAYMENTS

Report: Table 9.5: lines:	
1.	1. Balance on "regular types of transactions" (but excluding U.S. private liquid assets abroad)
	2. U.S. Government liquid liabilities to:
2a.	a. Foreign official non-monetary institutions
2c.	b. International non-monetary institutions
3.	3. Advances on U.S. military exports
4, 5, 9b.	4. U.S. Government nonmarketable, medium-term non-convertible securities sold abroad
(Table 9.4)	5. Marketable U.S. Government bonds and notes sold to "other" foreigners
7.	6. Advance repayments of U.S. Government loans
	A. Total payments surplus or deficit

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	7. U.S. private liquid liabilities to:
2b.	a. Foreign commercial banks
2d.	b. Other private foreigners
	8. Foreign private liquid liabilities to the U.S.
	B. Total net private liquid liabilities (7 + 8)
9a.	9. U.S. liquid liabilities to official monetary institutions
10.	10. U.S. monetary reserve assets
	C. U.S. official Reserve Transactions (9 + 10)
	D. Total payments deficit or surplus (B + C; equals line A with sign reversed)

NOTES TO PROPOSED GENERAL FORM OF STATEMENT

An attempt was made to insert actual dollar values for 1964 in the form, but the data easily available were insufficient to make the attempt completely successful. The chief difficulties arose over liquid private U.S. assets abroad, and over the treatment in the report of nonconvertible U.S. securities. Values are hence omitted.

It was obvious, however, that the total deficit for 1964 as calculated according to the form would be a good deal closer to the deficit computed by Commerce than to that calculated in the report (see report, table 1). The same thing would be true for most and perhaps all of the years since 1958.

Comments are also necessary on certain specific items in the form.

Line 4.—The report treatment of nonconvertible U.S. Government securities sold abroad varies. Those sold to the Swiss are placed "above the line"; it is not clear to me how those sold to Canada were finally handled (report, table 9.5, and p. 111, col. 2); and those sold to foreign monetary institutions are placed "below the line." Even with respect to the last category, however, I am no convinced by the argument in the report (pp. 111–112). Since the securities in question are both nonmarketable and nonconvertible, they are not a currently available monetary reserve asset for the buyer. Rather, they are more closely analogous to investment purchases by foreigners of any other prime U.S. security, especially governments. If their purchase served to reduce our gold exports in certain cases (report, p. 112), any other purchases of U.S. Government short-term securities by the foreign institution would surely have served equally well.

Line. 5.—These transactions are likewise more akin to investment operations than to changes in U.S. liquid liabilities. See the brief comments near the end of section I.2, above.

Line 8.—Since U.S. private liquid liabilities are included as a balancing item (line 7), symmetry obviously requires line 8 too. It may be argued that a large part of such assets are effectively immobile under any but the most extreme circumstances (constituting, for example, commercial working balances). But the same thing must also be true of a good deal of line 7, though the proportion is doubtless much smaller.

Line 9.—Excludes nonconvertible U.S. securities, for the reasons indicated in the note for line 4.

Senator PROXMIRE: Mr Fousek?

Mr. FOUSEK. Mr. Chairman, as requested, I have a written statement to submit for the record if the committee so wishes. I plan to confine my oral presentation to the highlights of that statement.

Senator PROXMIRE. Fine.

Mr. FOUSEK. The Review Committee for Balance of Payments Statistics has done an outstanding job in its valuable and much-needed examination of U.S. balance of payments data. Their work has pointed up the shortcomings of the statistics now available and suggested many improvements in the quality of the data.

These recommendations are not controversial, but this in no way detracts from their importance. We should, however, keep in mind that the Commerce Department's Balance of Payments Division has always maintained the highest standards in this difficult field, despite the absence until recently of broad public interest.

In the long run, the acceptance and implementation of the Review Committee's suggestions for enlarging the staff of the Balance of Payments Division of the Commerce Department, for the institution of new surveys and other improvements in data collection, and for the overall revision of the presentation of the material, seem likely to be of far greater importance than any revision that may be made in concepts underlying the summary balances.

In contrast, the Review Committee's recommendations for the introduction of a new main summary indicator of the balance of payments, the so-called official settlements balance, are controversial, and, as the committee itself admits, open to questioning.

I do not find the committee's arguments persuasive. For one, I cannot accept the committee's conclusion that there can only be one summary balance. At the same time, I believe that because of the special role of the dollar in the international financial mechanism, the official settlements concept, even though it is important, could be seriously misleading if used exclusively.

While I also see problems with the present, so-called liquidity concept, it seems to me that we do need a summary measure that would reflect our liquidity position—again because of the key currency function of the dollar.

Thus, there appears to be no escape from the need to use two summary balances—the present one, perhaps somewhat modified, and the one recommended by the Review Committee.

In the remainder of my oral presentation, I would like to concentrate on some major problems connected with the official settlements concept.

The Review Committee recognizes that changes in U.S. short-term liabilities to foreign commercial banks pose particularly difficult problems for the application of the official settlements concept. It accordingly recommends that these liabilities be shown prominently as a separate category, but "above the line."

To me, however, the close substitutability between foreign commercial bank and official dollar holdings is a compelling reason against an exclusive reliance on the "official settlements" concept.

The intimate connection between the dollar holdings of foreign commercial banks and of foreign central banks creates two main difficulties that deserve emphasis: first, there are those arising from the existence of Euro-dollar market, and second, those stemming from forward exchange operations of both the United States and of foreign monetary authorities.

Direct Euro-dollar placements by central banks can seriously exaggerate the apparent changes in the balance of payments from period to period under the "official settlements" concept.

Perhaps more important is the fact that the Euro-dollar market has increased the degree to which the "vehicle currency" role of the dollar blurs the distinction between foreign private and official dollar balances, a point to which the Review Committee has perhaps not paid enough attention.

As a result of the dollar's reserve currency status, payments between foreign countries generally are made through dollars. This use of the dollar may well result in shifts of dollar liabilities from private holders in one country to official hands in another or vice versa, irrespective of changes in either the overall U.S. balance of payments or the current U.S. bilateral balance with either of these countries.

Under the "official settlements" concept, such shifts could appear as a strengthening or weakening of the U.S. payments position and, in the circumstances, clearly would be a false guide to policy.

The great resilience and flexibility of the Euro-dollar market has meant that the market can temporarily absorb significant inflows from official hands, or, on the other hand, can provide large temporary additions to official balances.

Last fall's sterling crisis provides a case in point. With sterling under pressure, the British authorities supplied dollars to the market (from their own holdings or from credits from other central banks—for this purpose from outside of the United States). These dollars, however, did not all immediately flow into other official reserves. A significant part came to be temporarily held in private hands, mainly in the form of Euro-dollars. On the "official settlements" basis, the U.S. balance of payments benefited. The present concept, in contrast, gave a much truer picture.

Official exchange operations of both the United States and foreign monetary authorities pose an even more serious obstacle to the usefulness of the "official settlements" concept. Such operations, mainly in the forward market, influence the willingness of foreign commercial banks to hold dollars and are designed to shift dollar balances from foreign official monetary institutions to foreign commercial banks, or vice versa.

In the first place, foreign monetary authorities undertake such operations to accomplish purely domestic monetary policy objectives—open market operations in dollars replace operations in local currency because of the thinness of domestic money markets.

Second, official U.S. exchange operations carried out in conjunction, or in agreement with, foreign monetary authorities—as part of the defense of the dollar and the U.S. gold stock—affect the distribution of dollar balances between private and official foreign holders.

Both these types of operations are normally reversed after a period of months. As a result, they affect the "official settlements" concept not only in the period in which they are made, but also in the period in which they are unwound. The quarter-to-quarter distortions can be huge—in recent years there have been quite a few 3-month periods when they amounted to several hundred million dollars, exceeding $1 billion or, on occasion, even $2 billion, on an annual basis.

Most of these operations, moreover, due to their very nature, cannot be revealed to the public except as a matter of historical record after a more or less lengthy timelag. No current adjustments in the official settlement balance could, therefore, be published.

A few examples of recent official operations indicate the size of this problem. The German Federal Bank and the Bank of Italy have carried out the largest operations of this nature in order to affect domestic liquidity.

The German Central Bank has done so in every year since 1958. In both 1961 and 1962 its dollar placements with German commercial banks, in the form of preferential swap transactions, reached $1 billion. There have been about a dozen quarter-to-quarter changes when these German operations affected the official settlements concept by $200 million or more, including several when the impact was $2 billion or more on an annual rate basis; and very few such periods when there was no effect.

The Bank of Italy's placements of dollars with Italian commercial banks through swaps and deposits likewise reached $1 billion. The quarterly swings in the volume of the Bank of Italy's outstanding placements havs not been as pronounced, but they have exceeded $200 million on several occasions, at one time reaching as high as $400 million.

Official U.S. forward exchange operations have never reached such high outstanding totals. But the impact on quarter-to-quarter changes in the official settlements balance has been large and has exceeded $250 million four times since early 1961 when these operations were first undertaken, and at one time the impact was almost $400 million.

The U.S. authorities have by now carried out forward operations in six foreign currencies: German marks, Italian lira, Swiss francs, Dutch guilders, pounds sterling, and Canadian dollars.

These operations, just as the similar but domestically oriented transactions of foreign central banks, are not an occasional development for which easy adjustment is possible. They are a continuing phenomenon of the present international financial structure that in most quarters of the past 6 years would have introduced sizable distortions regarding the size or direction of changes in the U.S. payments position as measured by the official settlements concepts.

In summary, there has been, and there continues to be a very close tie between foreign private and official dollar assets. As long as: (1) foreign central banks retain close supervision over the foreign exchange operations and positions of their commercial banks; (2) the dollar functions as the major medium for private international financial transactions; and (3) the Euro-dollar market serves as a general national and international money market for foreign countries, the U.S. balance of payments policy must be formulated on the basis of measures of the U.S. payments position that take fully into account not only official dollar holdings, but also those of foreign commercial banks.

Thank you.

Senator PROXMIRE. Thank you very much, Mr. Fousek.

PREPARED STATEMENT OF PETER FOUSEK, ASSISTANT VICE PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

THE REPORT OF THE REVIEW COMMITTEE FOR BALANCE OF PAYMENTS STATISTICS

The Review Committee for Balance of Payments Statistics has done an outstanding job in its valuable and much needed examination of U.S. balance of payments data. Their work has pointed up the shortcomings of the statistics now available and suggested many improvements in the quality of the data. The Committee has also recommended the adoption of a new main summary indicator of the balance of payments, the so-called official settlements balance.

The Committee's recommendations for upgrading the quality of the balance of payments data are not controversial, but this in no way detracts from their importance. We should, however, keep in mind that the Commerce Department's Balance of Payments Division has always maintained the highest standards in this difficult field, despite the absence until recently of broad public interest. In the long run, the acceptance and implementation of the Review Committee's suggestions for enlarging the staff of the Balance of Payments Division of the Commerce Department, for the institution of new surveys and other improvements in data collection, and for the overall revision of the presentation of the material, seem likely to be of far greater importance than any revision that may be made in concepts underlying the summary balances.

It is reassuring to have the Review Committee's conclusion that the weaknesses in the present statistics probably have not been so great as to have led to any erroneous decisions in the past, but it is clear that the dangers exist. Policy, after all, is framed not merely in terms of the size of the total payments deficit or surplus, but also in relation to the significance of the various components of that balance. The Review Committee has rightly emphasized how weak are the foundations underlying some of the most important categories of expenditures and receipts. Thus, it is of vital importance that adequate support be given to the Committee's recommendations regarding data collection and analysis.

In the area of the presentation of the data, the Committee's proposals regarding the summary balance are controversial, and—as the Committee itself admits—open to questioning. I do not find the Committee's arguments persuasive. After a careful review of various concepts of the deficit or surplus, the Committee has decided that there can only be one summary balance. It then went on to recommend changing the definition of the balance in U.S. international payments transactions from the present concept designed to measure our overall liquidity position to one that would include only "official settlements" as the measure of the balance. The recommended concept focuses on changes in U.S. official assets and U.S. liabilities to foreign official holders, shifting "above the line" changes in U.S. liabilities to private foreigners.

In the remainder of this statement, I would like to concentrate on the question of a summary balance and discuss the Committee's conclusions regarding, first, the inadequacies if finds in the present liquid liabilities concept; second, the advantages it sees in the official settlements concept; and, third, the question of a single measure of the deficit or surplus.

1. The definition of the balance of payments surplus or deficit now used by the Commerce Department is designed to measure the changes in the potential exposure of the U.S. gold stock by adding up changes in U.S. international reserves,

foreign official holdings of liquid liabilities of the United States, and foreign private holdings of such liquid claims on this country. Under this procedure, a reflow from abroad of short-term private U.S. capital improves our balance of payments, but an inflow of short-term private foreign capital, which is treated as a below-the-line settlement item, does not.

This asymmetrical treatment has occasioned much criticism. The basic rationale for the current approach, developed by the Commerce Department, is that liquid dollar holdings of private foreigners represent a relatively immediate threat to the U.S. gold stock, since they are, or can be, closely controlled by foreign monetary authorities, and thus can readily be transferred into official hands. (Domestic U.S. capital, of course, can fall under no such foreign control.) On the other hand, private U.S. claims on foreigners are not readily mobilizable for official U.S. use in defense of the gold stock.

That this approach is not symmetrical either internally or internationally is perfectly clear. It must be recognized, however, that the international role of the dollar is not symmetrical with that of other currencies. The unique role of the dollar in international payments places special responsibilities on the United States as banker to the world. At the same time, it has blurred the distinction between our liabilities to private and official holders. In most countries, private and official dollar holdings are closely linked. As a result, our liabilities to private foreigners have a special significance in U.S. payments that has no counterpart in the case of foreign countries. Changes in the U.S. liquidity position consequently will not be reflected properly by a measure that disregards them.

The Review Committee has pointed out that if the objective is to measure changes in the liquidity position of the United States as a threat to the gold stock, the present concept is inadequate because domestic holders of dollars can readily transfer funds abroad in periods of speculation against the dollar. There is, however, no way in which a measure of this exposure of our gold stock can be included in our balance of payments statistics. With the key currency role of the dollar, the liquidity concept is needed, and we must measure changes in our liquidity position the best way we can.

There are other problems with the present procedure, but these can probably be resolved through appropriate adjustments. For example, some part of our liabilities to foreign private holders represent the secular growth of working balances, while part are immobilized in the form of compensating balances related to U.S. bank lending abroad. And such balances seem in general unlikely to pose a serious threat to the U.S. gold stock. It is clear, however, that what holders consider to be "necessary" working balances at one time may change under altered circumstances; in times of exchange speculation, in particular, even such "necessary" balances may shrink drastically.

In addition, there is the question of liabilities to foreigners that arise out of the intermediary role of foreign commercial banks. In particular, Canadian banks accept U.S. dollar deposits from corporations and other entities in the United States and place the funds in our call loan market and in other money market instruments. In this function, Canadian banks are no different from U.S. financial intermediaries, yet under present accounting procedures such flows have a profound effect on our balance of payments statistics. The problem of taking this phenomenon into account in the balance of payments is complicated by the fact that in their U.S. dollar operations Canadian banks not only serve as intermediaries in the U.S. money market but also accept and place Euro-dollar funds in other countries and conduct a variety of U.S. dollar operations with Canadians as well.

All this suggests to me that it might be desirable if it were feasible to make some changes in our accounting procedures to enable us to offset against certain liabilities to private foreigners, such as those resulting from U.S. dollar deposits of U.S. residents with Canadian banks, the immediately corresponding U.S. private claims on foreigners. This problem is technically difficult, but it cannot be dealt with simply by ignoring liabilities to private foreigners in measuring the U.S. deficit or surplus.

2. The Review Committee bases its advocacy of the official settlement concept on the view that in the present international system "the key demarcation in international transactions is between those of the monetary authorities and all other transactions." According to the Committee, "the monetary authorities fill the gap between the private demand for and the private supply of foreign exchange," and the size of this gap is "the most useful starting point for balance of payments analysis." This is an attractive approach to balance of payments accounting, but it seems most suitable for nonreserve currency countries. The special role of the dollar in the international financial mechanism suggests that even in theory

one cannot usefully employ the same concepts of deficit and surplus in the balance of payments of the United States that would be appropriate for nonreserve countries. And in practice, the reserve role of the dollar substantially reduces the usefulness of the official settlements concept.

The Review Committee itself points out that "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." It then goes on to say that the official settlements concept involves fewer problems of measurement than any other alternative.

Nevertheless, the Committee recognizes that changes in U.S. short-term liabilities to foreign commercial banks pose a particularly difficult problem for the application of the official settlements concept. It accordingly recommends that these liabilities be shown prominently as a separate category above the line. To me, however, the close substitutability between foreign commercial bank and official dollar holdings is a compelling reason for retaining in the measurement of the U.S. deficit or surplus some measure of changes in short-term liabilities to foreign commercial banks.

This reason for retaining liabilities to foreign commercial banks below the line remains valid, moreover, even if one is not primarily concerned with measuring changes in the overall U.S. international liquidity position, but wishes to measure—as does the Review Committee—the international transactions of the monetary authorities. The fact is that foreign central banks, as will be discussed further below, buy dollars from, and sell dollars to, their commercial banks not merely to settle imbalances in international payments, but also, and on occasion primarily, to influence domestic monetary conditions.

The intimate connection between the dollar holdings of foreign commercial banks and foreign central banks creates two particular difficulties—both recognized by the Committee—that deserve emphasis: first, those arising from the existence of Euro-dollar market, and second—and perhaps more important—those stemming from forward exchange operations of both the United States and foreign monetary authorities.

The existence of the Euro-dollar market has altered the significance of the measure of our liquid liabilities to official foreigners. A number of central banks place funds of their own in the Euro-dollar market because of the higher interest rates available there than in time deposits in the United States. And yet these Euro-dollar deposits are as much a potential claim on U.S. gold as official dollar balances held directly in the United States. At present, official holdings of Euro-dollars may be guessed to amount to about one-half billion dollars, and in the past they probably reached a level several times as large. More important, these holdings have changed substantially over short periods and may do so again. Since the counterpart of these official holdings of Euro-dollars may show up in our statistics as liabilities to private holders, the possible distortion of the U.S. balance of payments from this factor is considerable.

Euro-dollar transactions by central banks could seriously exaggerate the apparent changes in the balance of payments from period to period under the official settlements concept. The placement of Euro-dollar deposits by a central bank in any one period would mean a reduction in reported official holdings of dollars in the United States, and their switch into U.S. money market assets in another period would mean an increase in reported official holdings. Thus, the period to period swing would be twice the actual volume of such flows. Under the present liquid liabilities concept, of course, such flows would have no net balance of payments effect.

In addition, the Euro-dollar market has increased the degree to which the "vehicle currency" role of the dollar blurs the distinction between foreign private and official dollar balances, a point to which the Committee has perhaps not paid enough attention. As a result of dollar's reserve currency status, payments between foreign countries generally are made through dollars. This use of the dollar may well result in shifts of dollar liabilities from private holders in one country to official hands in another or vice versa, irrespective of changes in either the overall U.S. balance of payments or the current U.S. bilateral balance with either of the countries. Under the official settlements concept, such shifts could appear as a strengthening or weakening of the U.S. payments position and in the circumstances clearly would be a false guide to policy.

The great resiliency and flexibility of the Euro-dollar market has meant that the market can temporarily absorb significant inflows from official hands, or on the other hand, can provide large temporary additions to official balances. Last fall's sterling crisis provides a case in point. With sterling under pressure, the

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British authorities supplied dollars to the market (from their own holdings or from credits from other central banks—for this purpose from outside of the United States). These dollars, however, did not all immediately flow into other official reserves. A significant part came to be temporarily held in private hands, mainly in the form of Euro-dollars. On the official settlements basis, the U.S. balance of payments benefited. The present concept, in contrast, gave a much truer picture.

The opposite seems to have occurred in March 1961 following the revaluation of the German mark and Dutch guilder, which led to large movements of funds across the exchanges. In the first 4 days following these currency changes, some $300 million entered Switzerland and there were even larger flows into Germany. Some of the funds involved came from the United States, but a very large part represented funds either withdrawn from the United Kingdom or borrowed in the Euro-dollar market. The heavy inflow of funds into Germany and Switzerland brought both central banks into the market as residual buyers of dollars because nearly all the movement took place through dollars. Although a greater part of these flows obviously occurred between official accounts (United Kingdom reserves were bolstered by $900 million of short-term credits but still fell $750 million by August), there were substantial shifts from private to official hands. Under the official settlements concept, these purely intra-European flows would have meant a deterioration in the U.S. balance of payments, even though the overall U.S. balance of payments position was only peripherally involved.

Official exchange operations by both the United States and foreign monetary authorities pose an even more serious obstacle to the usefulness of the official settlements concept. Such operations, mainly in the forward market, influence the willingness of foreign commercial banks to hold dollars and are designed to shift dollar balances from foreign official monetary institutions to foreign commercial banks or vice versa. In the first place, foreign monetary authorities undertake such operations to accomplish domestic monetary policy objectives—open market operations in dollars replace operations in local currency because of the thinness of domestic money markets. Second, official U.S. exchange operations carried out in conjunction, or in agreement with, foreign monetary authorities affect the distribution of dollar balances between private and official foreign holders as part of the defense of the dollar and the U.S. gold stock.

Both these types of operations are normally reversed after a period of months. As a result, they affect the official settlements concept not only in the period in which they are made, but also in the period in which they are unwound. The quarter to quarter distortions can be huge—in recent years there have been quite a few three-month periods when they amounted to several hundred million dollars, exceeding $1 billion or, on occasion, even $2 billion, on an annual rate basis. Most of these operations, moreover, due to their very nature, cannot be revealed to the public except as a matter of historical record after a more or less lengthy time lag. No current adjustments in the official settlement balance could, therefore, be published.

A few examples of recent official operations indicate the size of this problem. The German Federal Bank and the Bank of Italy have carried out the largest operations of this nature in order to affect domestic liquidity. The German central bank has done so in every year since 1958. In both 1961 and 1962 its dollar placements with German commercial banks, in the form of preferential swap transactions, reached $1 billion. There have been about a dozen quarter to quarter changes when these German operations affected the official settlements concept by $200 million or more, including several when the impact was $2 billion or more on an annual rate basis; and very few such periods when there was no effect. The Bank of Italy's placements of dollars with Italian commercial banks through swaps and deposits likewise reached $1 billion. The quarterly swings in the volume of its outstanding placements have not been as pronounced, but they have exceeded $200 million on several occasions, at one time reaching as high as $400 million.

Official U.S. forward exchange operations have never reached such high outstanding totals. But the impact on quarter to quarter changes in the "official settlements" balance has been large and has exceeded $250 million four times since early 1961 when these operations were first undertaken, and at one time the impact was almost $400 million. The U.S. authorities have by now carried out forward operations in six foreign currencies; German marks, Italian lire, Swiss francs, Dutch guilders, pounds sterling and Canadian dollars. These operations, just as the similar but domestically oriented transactions of foreign central banks, are not an occasional development for which easy adjustment is possible. They are a continuing phenomenon of the present international financial structure that in most quarters of the past 6 years would have introduced substantial distortions regarding the size or direction of changes in the U.S. payments position as measured by official settlements.

As all of these points demonstrate there has been and there continues to be a very close tie between foreign private and official dollar assets. As long as: (1) foreign central banks retain close supervision over the foreign exchange operations and positions of their commercial banks; (2) the dollar functions as the major medium for private international financial transactions; and (3) the Euro-dollar market serves as a general national and international money market for foreign countries, United States balance of payments policy must be formulated on the basis of measures of the United States payments position that take fully into account not only official dollar holdings but also those of foreign commercial banks. Thus, there seems to be no escape from the need to show below the line not only official settlements, but also liabilities to foreign commercial banks.

If the official settlements concept were to be adopted exclusively, users of the data would have to make continuous adjustments in the regular statistics to achieve a meaningful figure for official settlements. As has been already pointed out, the data for the adjustments that would be required would, however, generally not be available without a more or less lengthy timelag. Sometimes the adjustments could never be meaningfully made. It must be emphasized again that the differences between the "reported" and the "true" official settlements cannot simply be written off as minor, or as no greater than present errors.

3. A reading of the Review Committee's report, particularly chapter 9, makes clear that the Committee is well aware of these problems in the use of the official settlements concept. Although the Committee ultimately finds these limitations to be insufficient grounds for rejecting the adoption of the official settlements concept, its arguments to this effect certainly are not conclusive and I do not find them persuasive. The problem quite clearly is that there is no single concept of the balance of payments surplus or deficit that is fully satisfactory for all or even for most uses of balance of payments analysis. Consequently, to insist upon the choice of a single concept is to force oneself to make a highly arbitrary and essentially unsatisfactory choice.

The Review Committee itself clearly recognized this problem when it noted that "no single number can adequately describe the international position of the United States during any given period," and went on to say "we explicitly reject the notion that as a practical matter people must view the balance of payments position in terms of a single summary concept, the surplus or deficit." Indeed, the committee quite persuasively argued the case against choosing a single concept of the deficit or surplus.

The Review Committee nevertheless held that an appropriately qualified choice was both necessary and desirable. I do not believe that this recommendation is well taken. It is obvious that for fruitful analysis of the balance of payments position, one must employ a variety of concepts and must study carefully a wide range of payments variables. It is simply not meaningful to say that in a given period the United States had such and such a deficit or surplus in its balance of payments without specifying the composition of that deficit or surplus. Thus it does not seem to me that anything is to be gained from an official presentation of the balance of payments accounts that encourages the lay or professional public to believe that any single number is in fact a valid expression of the U.S. international position.

It will be argued that people will inevitably seek to find a single number expression as a convenient shorthand for discussing the balance of payments. I cannot accept this argument. Virtually all balance of payments analysts are agreed on the necessity for multiple concepts of the payments position, the choice in any given case depending on the problem or policy to be considered.

There seems no valid reason, therefore, why the U.S. Government's official presentation of this position should cater to, or indeed encourage a more simple-minded and necessarily unsatisfactory approach. The balance of payments is a highly complex piece of national and international accounting that requires sophisticated interpretation and analysis. Naturally it is unreasonable to expect such analysis from the general public, but it does not seem that this implies as an alternative that we must accept the use of unsatisfactory summary concepts.

It seems preferable to have a presentation organized in such manner that the various major components can be readily observed and put together in a manner that will be most useful to the analyst. Such an approach will, over time, yield far more satisfactory results and should make possible the gradual development of better public understanding of the nature of the balance of payments and of the specific types of problems that may arise from time to time. Further refinement of the existing data and a presentation with two summary balances rather than one seem likely to prove the most fruitful avenues of development.

Senator PROXMIRE: Our last witness is Mr. Holton.

STATEMENT OF RICHARD H. HOLTON, PROFESSOR OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA AT BERKELEY

Mr. HOLTON. Thank you, Mr. Chairman.

My prepared statement is brief, and with your permission I will read it into the record.

I am pleased to have this opportunity to comment on the report of the review committee for balance of payments statistics. My great interest in the work of this committee stems largely from my having served, from early in 1964 through January of this year, in the Department of Commerce as Assistant Secretary for Economic Affairs.

One of my continuing assignments in that position was the policy supervision of the Office of Business Economics, which as you know is charged with the responsibility of assembling the balance of payments statistics. The Assistant Secretary for Economic Affairs also had the responsibility for organizing the staff work needed by the Secretary in his capacity as a member of the Cabinet committee on the balance of payments.

In the Department of Commerce we welcomed the idea that this review committee be established. It was clear that the great interest in the balance of payments problems of the United States put our balance of payments statistics in the spotlight, and so it was wholly appropriate that the quality of these statistics and the manner in which they are presented should be carefully appraised by a group of experts chosen from people outside the Government service.

Over the last decade or so, and especially over the years since the balance of payments of the United States had become a problem of real concern, a number of new types of transactions had developed which lent themselves to more than one interpretation. This led, understandably, to a certain amount of self-consciousness of the part of those charged with assembling and presenting the data, particularly because the balance of payments performance of the United States, as reflected in the quarterly reports of the Office of Business Economics, was more than ever before the subject of worldwide attention.

The Bernstein Committee has performed an outstanding service and is to be congratulated on the detail and thoughtfulness of their report. I agree with most of their recommendations.

I appreciate, Mr. Chairman, that you are especially interested in certain of the conceptual problems at issue in the report. Before commenting on these, however, I would like to discuss briefly the quality of the data. The majority of the Committee's recommendations have to do with this aspect of the problem, and I think it important that we not lose sight of these by focusing exclusively on the question of the best definition of the balance.

I fully share the Committee's great concern about the thin ranks in the Balance of Payments Division in the Office of Business Economics. The report notes, on page 171, that—

* * * the Division is precariously dependent on a handful of experienced people.

It illustrates the point by noting the difficulties which arose when one senior member of the staff died and when another resigned on short notice. The entire Division staff now consists of between 50 and 60 people.

The Review Committee recommends that this staff be increased by 15 or 20 persons. Incidentally, I would question, Mr. Chairman, whether or not the recommendations of the Committee could actually be carried out by such a relatively small increase in the number of staff. A suggestion that any staff in the Federal Government be increased by one-third or more obviously should be examined carefully.

In the hearings of May 11, Senator Proxmire indicated that the cost of improving the balance of payments seemed substantial, and he was quite properly seeking justification for such an increase in expenditures in this area. I would like to focus on this budgetary problem briefly.

Our balance of payments statistics suffer from a problem that is common among Government statistical programs. Typically it is rather difficult to persuade an appropriations committee that any given statistical program is needed.

One reason for this is that statistical programs often lack a politically strong constituency. The users of economic statistics are usually two or three echelons down from the top management in the modern corporation; and when the management reads a staff report on, say, a market analysis of some sort, they probably do not realize the extent to which Government data went into the report.

The management is aware, however, that filling out Government questionnaires of various sorts takes time, so they do complain about this cost. Generally, the OBE and census data are picked up and repackaged by the financial press, trade journals, bank letters and even the front pages of our daily newspapers.

It is good that the data are so widely publicized. In this repackaging process, however, the source commonly is not identified; trade journal articles often leave the impression that the trade association, rather than the Federal Government, collected the data discussed. Thus the users of economic data may underestimate the role of the Federal Government in providing economic statistics.

Another difficulty stems from the fact that users of the data are often not those who must fill out the Government forms which provide the data to the statistical agencies in the first place.

Thus one finds, for example, that the Census Bureau has received nearly simultaneously two letters from the same company, one from the comptroller complaining bitterly about filling out a form with information which he thinks surely no one ever uses, the other from the market research man in the same company asking Census if they can possibly provide him with more detail than the published Census reports show. The letter of complaint typically goes to a Senator or Congressman, while the letter asking for more information goes directly to the Census Bureau.

No wonder, then, that Congressmen and Senators often feel that the Federal Government is already collecting too much statistical information; they hear more about the complaints than about the uses.

Our balance of payments statistics may have suffered doubly from this problem because there are relatively few users of the detailed data. Yet these are people in key places in private firms, in our own Government and in other governments. The decisions affected by the data may be of immense consequence for not only the United States but other countries as well. Certainly the experience of the last few years should have taught us how important it is that we have good data on our balance of payments, even though there may be comparatively few users of the data.

(Senator Javits entered the hearing room at this point.)

Mr. HOLTON. How much should we be spending on our balance of payments statistics? What is the value of economic information? The question is virtually impossible to answer. We must try by other means to put into perspective the budgetary implications of the Bernstein Committee's report.

The additional 15 or 20 persons recommended for the Balance of Payments Division would cost something on the order of $250,000 per year. By my very rough calculations, this amount could be recouped in tax revenues to the Federal Government if our GNP were to be about $2 million higher than it would otherwise be, thanks to better decisions stemming from the improved data. Two million dollars is about one-third of one one-thousandth of 1 percent of current GNP.

Considering the importance of our balance of payments statistics in determining our monetary and fiscal policies alone in this country, I would think that improved decisions in this one area could easily improve the performance of the economy enough to warrant the expenditures suggested.

I appreciate that this is a very crude way, indeed, to consider the possible value of improvements in the quality of our balance of payments statistics, but it may be of some use.

Another means of putting this $250,000 into perspective is to consider the expenditure on certain other programs. The Office of Business Economics is the smallest bureau in the Department of Commerce. The OBE budget in fiscal 1965 is roughly $2.4 million, about one-fourth of which is represented by the Balance of Payments Division.

The National Bureau of Standards, by contrast with the Department of Commerce, had a budget of $30 million, and the salaries and expenses in the Weather Bureau come to $65 million. For these two agencies combined, the increase requested for fiscal 1966 was well over $10 million, four times the total OBE budget.

In the Department of Agriculture, the Economic Research Service has a budget of $10.6 million, four times the size of OBE. One could go on with such comparisons, but to me the point is already clear: the budget of the Balance of Payments Division is surprisingly small, and the increase recommended by the Bernstein Committee should be implemented as soon as possible.

I appreciate that the budgetary implications of the Bernstein Committee report go well beyond the recommended increase for the Balance of Payments Division. I feel certain, however, that expenditures in other agencies as well as in OBE designed to meet the objectives of the Committee's report would be very well advised indeed.

Let me emphasize the many benefits from these greater expenditures on balance of payments statistics. Policymakers and scholars would be able to do a better job of analysis, as Professor Kenen emphasized before this committee last month. We cannot hope to understand the mechanics of the balance of payments mechanism unless we have reliable data in adequate detail.

It is little short of appalling that we have some series benchmarked back as far as 1949. With improved data, more researchers can ask questions of the data. Thus, the Federal Government would be encouraging further research on balance of payments problems outside the Federal Government. Simply providing more and better data, therefore, can increase the amount of research conducted at no expense to the Federal Government.

I need not remind you of the tremendous bank of knowledge of economic policy matters which is represented by the non-Government academic and research community in this country. Congress and the executive branch benefit enormously from the existence of this knowledge. It can be expanded substantially simply by our supplying more and better data.

(At this point Senator Javits left the hearing room.)

Mr. Holton. A larger Balance of Payments Division staff would permit the staff itself to do more analysis; at the present time much too high a proportion of the staff time is spent merely putting the accounts together. The Review Committee has properly emphasized that—

> because of their familiarity with the latest data and trends, the economists in the BPD are equipped to make a particularly valuable contribution to basic analyses of balance of payments (p. 172).

With sufficient resources to support more analysis, the Balance of Payments Division could have a much easier time recruiting good people. It could also help provide more leadership for academicians and others in the whole field of research on balance of payments problems.

One final point on the question of budgetary support. I see no reason to think that the need for good balance of payments data is only temporary and that solving our balance of payments problem will lead to any reduction in the demand for details in the accounts.

The growing involvement of American business in the rest of the world, for example, is obviously not a transitory phenomenon. The great interest in economic development and in our economic relations with the developed countries is surely increasing over the long pull. It is quite appropriate, therefore, for us to argue that we should have better balance of payments data even if we were not presently facing a difficult balance of payments problem.

You have asked for our views of the foreign privately held dollar balances, which constitute the core of the distinction between the balance on the proposed "official settlements" basis and the balance based on the liquidity concept.

As I understand the debate, the issue turns on just how these foreign privately held dollar balances behave, and particularly on whether the foreign monetary authorities have sufficient access to them so that they should be considered as reserve liabilities, or potential reserve liabilities.

On balance I lean a bit toward the "official settlements" definition of the deficit, but I am vigorously opposed to the idea that this should be the only balance shown in the summary tabulation proposed by the Review Committee.

You have heard the pros and cons on the nature of these foreign privately held dollar balances, and I will not repeat them here, except to make one point. It is impressive there is so much uncertainty about the exact role of the various motivations behind the transactions involving the privately held dollar balances.

We know that some of these, in a substantial amount, can be essential in official rcserves or certainly potential reserves. It seems to me. Mr. Chairman, that we might look on the "liquidity" concept as giving us a measure of the balance of payments deficit which is in the nature of a leading indicator of further trouble.

If we want what we might think of as a "pure" measure of the deficit, perhaps the "official settlements" version is the best, but if we are looking for a measure which is to help us forecast what is likely to happen to this official deficit, then it seems to me the "liquidity" concept is appropriate.

You are familiar with the Business Cycle Developments publication of the Bureau of Census where great emphasis is put on leading indicators.

I would suggest the "liquidity" concept would be of most use as the indicator, and, therefore, of particular relevance for policy discussions. Nevertheless, the "official settlements" version could give us the static picture of this one version of the balance.

I would urge that your committee need not, and should not, make a final decision about which balance should be considered the deficit. The mere fact that the debate is so vigorous suggests that at least two balances should be presented in the summary table.

The critical issue here, it seems to me, is one's view of the responsibilities of a statistical and analytical agency such as the Office of Business Economics to the users of the data. The Review Committee has done a very good service indeed in specifying clearly the criteria for evaluating the manner in which the tables are constructed.

The Committee states, and I think quite rightly, that—

> The arrangement of the main balance of payments accounts should avoid unnecessary judgments about economic behavior, and should not be structured to support particular theories or policies * * * official presentations should aim at neutrality insofar as possible.

This idea should extend, I would argue, to providing the data in a form which will facilitate their use by people who may have different views about the relevance and nature of particular accounts. Clearly not all views can be fully accommodated, but surely when an issue as seriously as the foreign privately held dollar balances is involved, the tabular presentation should take this into account.

I am reminded, Mr. Chairman, of an experience I had several years ago. A government statistician (not in the Federal Government, I hasten to add) in charge of a particular survey of workers' incomes asked me whether he should publish the median income as well as the mean. He was inclined not to publish the former, on the grounds that, as he put it, "people so often misuse the median."

I pointed out that people are going to misuse statistics from time to time no matter what. It is up to the statistical agency only to present the data which accommodates the preferences of most of the users. It seems clear that there is sufficient support for the "liquidity" concept of the balance to warrant continuing it, side by side with the "official settlements" version.

I fully appreciate that financial writers and the general public like to have one figure, a single measure of the deficit. When we introduced the three different measures of the deficit in 1963, the financial reporters were most unhappy with us, and I know we complicated their lives considerably with the new presentation.

But the balance of payments problem is a complex one by its very nature, and I still feel that we did the right thing. I can see the validity of the deficit on an "official settlements" basis, and I think it should be introduced into the summary tables. But I feel that the Office of Business Economics would be negligent in carrying out its responsibilities to the users of the data if they were to abandon publication of a balance which so many users consider the proper measure.

Thank you, Mr. Chairman.

Senator Proxmire. Well, thank you, gentlemen, very, very much. These were very helpful statements.

I would like to start off by asking all three of you gentlemen, since you all seem to come down, roughly, on the same side, if you don't want to opt firmly and finally for either the liquidity definition or the official transaction definition as the single measure.

Mr. Angell wants, as I understand it, to have three alternative definitions, and Mr. Fousek and Mr. Holton both imply that there should be two, the present definition and also the official transactions.

Shouldn't the Federal Government, however difficult it may be, come down on the side of one definition so that people throughout the country and throughout the world know what the Federal Government officially says our balance of payments situation is, whether it is in surplus, whether it is deficit, whether worsening, or whether it is improving?

I realize that there are problems involved in doing so, in view of the fact that so many of our important policymakers in private life and in the Government are not economists and we cannot expect them to be economists. They are not people who can spend much time in considering the differences between these definitions.

Would it not be more useful for Senators, for the President of the United States, for Members of the House, for bank presidents, and even for most economists to have a single definition, either with the definition we have at the present time or the definition by Mr. Bernstein?

Mr. Angell, you were the first to speak. Suppose you start off.

Mr. Angell. As I said before, I think both figures, the "official settlements" figure and the Department of Commerce "liquidity" concept figure are essential. They have definite purposes. They mean definite things.

You need to know both in order to know what the total picture is.

My third category; the final line I ended up with, is not quite, but almost, the present Commerce figure. I also think it useful to have the private capital movements figure shown separately, because this is a dynamic and potentially dangerous element in our total situation.

I don't think any one figure can serve alone. All three should be presented.

Senator Proxmire. Mr. Fousek.

Mr. Fousek. Mr. Chairman, I do agree that life would be much simpler if we could have just one measure, but as Mr. Angell just said, the two measures do have definite purposes and we have other economic variables that are measured in several different ways—for example, in the Federal budget the deficit is shown on a cash basis and an administrative basis, and now in the last few years on a national income basis.

Senator PROXMIRE. That's true and we even have the gross national product shown on a constant dollar basis as well as on a current basis.

Mr. FOUSEK. Yes.

Senator PROXMIRE. And the growth of it, and so forth; but somehow, some way, maybe this would work out no matter what the Department of Commerce did in making its report.

So far as the budget and the gross national product are concerned, most people and the newspapers will fix on one as the definition they use, and there is not much disagreement. For the budget they fix on the administrative budget. Very few people use the cash or income accounts budget. And almost everybody uses the current dollar gross national product.

We seem to fix on a specific definition which is generally used, regardless of what we do. And since that's going to be done, don't you think that the true experts, the people who really understand it best, should make the decision rather than leave it up to the impression of some influential journalists or someone else who is not nearly as well informed.

Mr. FOUSEK. Mr. Chairman, it seems to me, it behooves the experts, the analysts in the Government, to try to educate the public and the financial journalists and try to explain the significance of these figures, because whichever concept would be used, whichever concept would be publicized, if it was used exclusively it could be misleading.

I know it is difficult to get the analysis and the interpretation across to the public, but I think we should try.

Senator PROXMIRE. Mr. Bernstein suggested there be at least two definitions for the time being. He did not say to dismiss the present definition. He wanted us to carry it for at least a while.

He wanted us to carry the "official transactions," figure but to continue with the other, too; and I said yesterday before we started questioning, and after the witness testified that there seems so be a general agreement that there is no single, final, satisfactory answer.

There is no substitute for a careful discriminating analysis, the trend may be more important or the size may be more important than the fact that we are in deficit and that we are in deficit must be determined on more than one basis.

But, nevertheless, recognizing the way things operate in the real world, and recognizing the real responsibilities the economists have as the best informed, the most knowledgeable—do you really think the Government can provide these two definitions indefinitely and that it will serve the best interests of the Congress and country by doing so?

Mr. HOLTON. Mr. Chairman, I think not only that they can provide the two balances indefinitely, but that they should.

As we all recognize, there is this preference of the public certainly for one single measure of the deficit. But a single measure is clearly incomplete. Perhaps I can make the point by suggesting a crude parallel.

To use just one measure of the deficit as a measure of performance might be a little bit like looking only at the sales figure for a machine tool company when assessing its performance. In this particular industry, for example, the order backlog is of great consequence, and so, one finds that in the analysis of a company in this industry, one must look at the order backlog as well as the sales performance.

It seems to me that the distinction between these two balances could be made clear to the journalists who write on this subject so that their articles could reflect the two balances and not just one.

I would emphasize that we don't cater to a public consisting of just one financial journalist. There is a market, so to speak, of journalists in this area, and by and large I would say that their writeups on the balance of payments have been quite satisfactory.

I would emphasize, too, that the articles on the balance of payments which appear rarely consist of one line or even one paragraph, and with any size at all it would be simple to indicate that on an "official settlements" basis, such and such happened to the deficit, but on a "liquidity" basis something else happened.

Senator PROXMIRE. Could you gentlemen give me an example of any country in the world which offers more than one statistic for its balance of payments?

Mr. FOUSEK. I can't recall any, except I would, Mr. Chairman, make the point that because of the key currency role of the dollar, our problems are perhaps more complicated than those of other countries.

Liabilities to private foreigners do not play the same role in the balance of payments of other countries that they do in this country.

Senator PROXMIRE. Is it true that the "official transactions" definitions would come closer to the definition used by other countries than the present definition that is used by the Department of Commerce?

Mr. ANGELL. To the best of my knowledge, yes, Mr. Chairman. I think, however, that if other countries had the same access to the same kinds of information on private and short-term capital that we have built up, they would be very glad to publish them, too.

Going back to your first point, I think the attempt to produce any one figure and stick with that would probably be misguided because I don't think any one figure is correct.

You have got to have both or even three.

Senator PROXMIRE. Well, let me ask you to answer the arguments where Mr. Bernstein scored most clearly, and see what's wrong with them.

You gentlemen have not mentioned very much, although the witnesses yesterday did, about the argument by Mr. Bernstein that his official transactions would work out to a zero symmetry. In other words, if all countries had a balance, by his definition, of an equal balance, there would be an aggregate, overall, international balance, no deficit, no surplus except for a modest, net accumulation of gold.

In other words, if you used the present Commerce definition, all countries in the world could be in deficit at the same time, and the aggregate world deficit could be a couple of billion dollars.

If we use the present definition, "our actual balance" in terms of whether or not the balance of payments situation is going to cause us difficulty in the future, our objective should be reaching a half billion to a billion dollar deficit, rather than a zero deficit.

A zero deficit, by the present definition, apparently puts us in surplus. These arguments seem to me, from the standpoint of sheer logic, to have some persuasiveness to them.

What is the answer?

Mr. FOUSEK. Mr. Chairman, on the question of symmetry, it seems to me that there is at the moment a great variety of concepts used. The Committee's report perhaps does not give quite that impression, but there are at least three different types of concepts used; some countries "net out" and put below the line all short-term private capital. Some net out only some types; some private capital is above, and some below, the line.

So, there is a great variety. If we were to achieve symmetry, everybody else would have to move on to the same concept.

Senator PROXMIRE. No. No, I am not arguing that—that they have to all move over into our definition. They don't now. They don't use our present definition. I'm sure they won't use any prospective definition. It is just so we would have a notion as to how we are contributing to the balance or imbalance, the deficit or surplus throughout the world.

Let me read what Mr. Bernstein says. He says:

> If every country used the deficit as the "official settlements" concept the aggregate net balance would be zero, except for the addition of new gold to the monetary reserves. Each country would have a small surplus if the increment of gold were reasonably equally divided.

It is true, they don't use this "official transactions." It is indicated that it is closer to what they do use than the present definition we have. Since there is this apparent balance, it seems to me there is a persuasive argument for us to consider this very, very seriously.

Your argument is that that may be so, that we should have it as one definition, but it should not be the only definition.

Mr. ANGELL. Mr. Chairman, I don't see that the symmetry argument carries force. If we think the other countries are not putting their figures on the basis which seems to us most reasonable or most useful, that's their fault.

Senator PROXMIRE. Let's for the moment forget the symmetry argument, although I think it does have some force.

Mr. ANGELL. My objective is that we also publish the "official transactions" figure, and anyone who wants it can obtain it by using other countries' official transactions figures to compare with ours. Then you get the symmetry.

Senator PROXMIRE. How do you answer the argument? If we are reaching a balance in the sense that we are in a stable position that we actually report on the present definition, a billion-dollar deficit.

Mr. ANGELL. You mean on the Commerce "liquidity" concept?

Senator PROXMIRE. Yes.

Mr. ANGELL. I would say on a real basis, the deficit is half a billion dollars, not zero. We really have a deficit of a billion, if I have the figures correctly.

Senator PROXMIRE. Yes. But you see, in doing this, what we are doing, we are creating a situation in which, if it is a half a billion dollars or a billion dollars, and we get to zero—zero is our objective—then, in effect, we are creating an adverse situation in other countries because their balance of payments must be a billion dollars negative.

Do you follow me? Does that make any sense?

Mr. ANGELL. I don't understand.

Senator PROXMIRE. Consider our balance of payments from the standpoint of the other countries of the world.

If we run a deficit of $3 billion, it means the rest of the world has a surplus of $3 billion. If we run a surplus $3 billion, the rest of the world has a deficit of $3 billion.

Mr. Bernstein's argument, as I understand it, is if we run a zero situation, by his definition, then the rest of the world can also have a zero situation.

But if we use the Commerce definition and have a billion-dollar deficit, then the rest of the world will in fact have a zero situation—a balance.

Mr. ANGELL. But Mr. Chairman——

Senator PROXMIRE. By the Commerce liquidity definition, if we have a zero balance, then other countries must have an adverse situation to the tune of about a billion dollars.

Mr. ANGELL. I can take all but the last proposition. If we have a billion dollars on the Commerce definition, and the other countries have the same kind of reporting, the same kind of reporting about their private liabilities and assets, there would be still a zero on the overall balance.

Our deficit would be exactly offset by the surpluses that the other countries report. The difficulty is not the concept, but the difficulty of lack of adequate statistics and other information on the part of the other countries.

Other countries have treated their private holdings as a matter of extreme secrecy. Central banks, and banks in general like the Swiss, are very loath to produce any information.

Senator PROXMIRE. My time is up. But just let me see if I understand you. If so, I think you have made a real contribution to my understanding.

Mr. Bernstein's argument is that according to the present Commerce definition, the "liquidity" definition, that if we have a zero balance, by this definition the rest of the world must be in deficit to the extent of perhaps a billion dollars.

Mr. ANGELL. I did not hear him speak. I don't see how he could reach that result without knowing about the other fellows' private liquid position. The liquid positions might also have been zero.

Senator PROXMIRE. I see. What he is doing is shifting the scenery a little bit, you mean.

Mr. ANGELL. That is correct.

Senator PROXMIRE. What he is saying is that, if we have half a billion dollars deficit by the "liquidity" concept, then he uses his own definition as far as the other countries are concerned, and they—by his own definition—they have a deficit.

Mr. ANGELL. True.

Senator PROXMIRE. But if we use the "liquidity" definition for everybody, it would balance out.

Mr. ANGELL. That is like comparing a cat with three legs with a cat with four legs, to put it crudely.

Senator PROXMIRE. Thank you, Mr. Angell, but I want to pursue this further on my next turn.

Mr. ELLSWORTH. Thank you for yielding, Mr. Chairman. And, Mr. Chairman—if I may—I still have some questions remaining in my mind along the same lines as the one you have been pursuing.

Mr. Angell, suppose that we drive to achieve a surplus on the "liquidity" concept, a dollar surplus, then from the standpoint of the rest of the world, are we not soaking up and absorbing from the rest of the world an awful lot of dollars that they otherwise would use for liquidity, and isn't that something that, from the standpoint of an expanding level of world trade, is contrary to our interests as well as the interests of the rest of the world?

Mr. ANGELL. Mr. Ellsworth, I agree. But that's part of what this interest equalization program is about. It is a policy matter, but not a statistical problem.

Mr. ELLSWORTH. But as far as the statistical concept problem to which we are addressing ourselves is concerned it seems to me that Mr. Bernstein is saying that if we drive for a surplus or even for a zero balance on the "liquidity" concept, we are soaking up an unnecessarily large amount of dollars from out of the rest of the world, whereas if we drive for a balance on his "official transactions" concept, then we would not soak up as many dollars out of the rest of the world.

Does that make sense, and if that makes sense, what is the validity of it?

Mr. ANGELL. Knowing him as an old friend and recalling what you have both quoted from him, he could not have said it, because the mere matter of how you count the surplus does not affect how many dollars you soak up.

You soak up the dollars anyway under the present policy of the Government. It does not matter how you count the surplus they get soaked up.

Mr. ELLSWORTH. But would you not soak up more dollars if you are driving toward a balance on the "liquidity" concept than it would if you were driving toward a balance on the "official settlements" concept?

Mr. AGNELL. The figures would show it that way.

Mr. ELLSWORTH. You are nodding your head, Mr. Fousek.

Mr. FOUSEK. I was thinking perhaps our aim should be different, at different times. At the present time since our deficit has continued for so long, perhaps our aim should be higher. That is, we should aim for a zero balance on the liquidity concept or perhaps even for a surplus.

Mr. ELLSWORTH. Yes.

Mr. FOUSEK. But in the longer run, the aims, our objectives, might change. I think that the statistical definition should not necessarily interfere with the policy aim. The policy aim can be phrased in either definition.

Mr. ANGELL. I think I understand your point now—Mr. Bernstein's point—Mr. Ellsworth. It is obviously true that if you think the deficit is $3 billion, you have to do a lot more than if you think it is $1 billon. So we are right back to where we started as to what the concept should be.

Both should be used, as I said before.

Mr. ELLSWORTH. It seems to me when Bernstein was testifying here, that one of his points was that it might be a mistake to try to aim for a zero balance or for a surplus under the liquidity concept, because to do so would unnecessarily soak too many dollars out of the rest of the world.

That, it seems to me, is a valid argument, but I want to go on and——

Mr. ANGELL. May I have one sentence?

Mr. ELLSWORTH. Yes.

Mr. ANGELL. I quite agree with what you have just said, but the point is not how you account for the deficit, how you measure it; the point is how many dollars do you want to soak up?

Mr. ELLSWORTH. That's right. That's the point.

That's correct, but the point in everyday terms is what target these Government policymakers fix on. And they are not sophisticated economists, and we are not sophisticated economists. What kind of target do they fix on, as a practical matter, in developing equalization taxes and voluntary guidelines, and things like that?

Is it an appropriate target to accomplish the overall objectives of the United States, or is it somehow or other an inappropriate target?

And Bernstein's thought was it might be inappropriate to fix on a zero balance under the liquidity concept.

Mr. ANGELL. If you cut down a billion dollars on the reserve transactions, then that is the policy objective, and that's all right.

You would then get a zero balance using reserve transactions as a basis. But in the case cited, you still have the $2 billion deficit on other accounts.

Mr. ELLSWORTH. And that might be all right. It may be appropriate to have that much.

Mr. ANGELL. That is a policy decision.

Mr. ELLSWORTH. I understand. I think we are at last understanding each other.

Now, I want to shift to another point and this is a question for all three gentlemen. Bernstein said in response to a question from Senator Proxmire, and I am quoting:

> 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.
>
> 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 the U.S. banks. Such funds can also move out and get into the hands of foreign monetary authorities.

Then on down a couple of paragraphs, he continues:

> 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 investments into the hands of foreign monetary authorities than out of the private liquid dollar assets, which the Balance of Payments Division regards as in the nature of a settlement item in the balance of payments.

Would you gentlemen like to comment on that observation by Bernstein?

Mr. FOUSEK. Mr. Ellsworth, as I have tried to point out in my statement, our liquid liabilities to private foreigners, particularly to foreign commercial banks, are very much different in my view from either U.S. residents' holdings of liquid dollars or foreign holdings of stocks, for this simple reason: That these balances are under the control or under the immediate influence of foreign monetary authorities. The operations of foreign central banks, whether purely for domestic reasons or as our own operations, for international reserve reasons, almost continuously have shifted these balances.

We, too, have shifted dollar balances back and forth between foreign commercial banks and foreign central banks. Resulting quarter-to-quarter changes are very large and I disagree with Mr. Bernstein saying that they are relatively minor, compared to the changes in the foreign commercial banks, holdings motivated by other reasons. These official transactions are clearly a very big factor behind the quarter-to-quarter changes of foreign commercial banks' dollar holdings.

Mr. ELLSWORTH. And I remember your giving a number of figures in your testimony, several—as high as $400 million in one quarter on a quarter-to-quarter basis. This is what Bernstein says about that:

> But the amounts involved * * * —

and he is referring to totals—

> are not of such magnitude in any one period or cumulatively to justify treating all changes in foreign commercial bank holdings of short-term receipts as settlement items.

Do you disagree with that?

Mr. FOUSEK. I would tend to agree that on an accumulative basis the problem is less important, because, as I tried to point out, these transactions, foreign and U.S. operations, are generally temporary. They are more often than not reversed within a relatively short period, so that on a cumulative basis, over a period of years, this should wash out. However, on a quarter-to-quarter basis they can be very substantial and we have even had some years, when even for a whole year, carrying one year to the next year, they made a difference of over half a billion dollars.

Mr. ELLSWORTH. What year was that?

Mr. FOUSEK. For example in 1964, when we had a relatively large increase in foreign commercial bank holdings of dollars, we also had an increase of several hundred million dollars in operations, both by the U.S. and foreign central banks, shifting dollars into foreign commercial banks' hands.

In the preceding year, official operations had the opposite effect. They brought dollars from foreign commercial banks into official banks, and, over those 2 years together, the official operations made over half a billion dollars difference.

So, the statistics——

Mr. ELLSWORTH. Go ahead.

Mr. FOUSEK (continuing). The statistics showed a very sharp jump in foreign commercial banks' holdings of dollars from 1963 to 1964. However, a good part of the jump was matched by a change in official operations.

Mr. ELLSWORTH. That leads directly to a very important question, which Mr. Holton brought up, and that is the question of the users of these statistics. I hope I am not misrepresenting Mr. Bernstein when I say that I got the impression from his testimony that he felt that the principal users of these statistics, or the most important users of these statistics, were central banks, and in fact I think he said that.

Mr. ANGELL. They already know.

Mr. ELLSWORTH. That is correct and in response to what you have just been saying, couldn't you say that those fellows all know and understand what's going on, so it wouldn't make too much difference.

What would you comment on that?

Mr. FOUSEK. I am not quite sure I understand Mr. Bernstein's point, but if he did say that the foreign central banks were the main users of our statistics, I am a little puzzled.

Mr. ELLSWORTH. Not foreign, just central banks. At one point I understood him to say that. Perhaps I musunderstood him on that.

Let me move on to another question. Mr. Holton, you made a point which also was made in the May letter of the Morgan Guaranty people where they had a very interesting article about this whole problem—about how the "liquidity" concept serves as a leading indicator of a situation, whereas the "official settlements" concept would serve as a coincident indicator.

I haven't had time myself or to ask the staff to check that out thoroughly. Have you checked that out thoroughly and seen that has actually been the case over the past several years—that the "liquidity" concept has indeed acted as a leading indicator of the situation?

Mr. HOLTON. No; I haven't. I was arguing more on conceptual grounds. If the foreign privately held dollars are in some substantial measure eligible to come directly into the hands of the monetary authorities, then the liquidity balance provides a rough measure of the potential problem. In this regard, incidentally, I would like to make a point pursuant to your earlier question.

It seems to me that, although we might be saying that as a rule these balances behave in certain ways, it might very well be that it is the exceptions that we want to be particularly sensitive to, and consequently, I think the "liquidity" concept being more likely to catch these exceptions, would alert policymakers to the existence of these and would be much more useful.

So, I would like to emphasize that the "liquidity" concept strikes me as being much more useful, if you want to take the view of the policymakers.

Now it is true that many users of the balance of payment statistics, for example, the treasurers of corporations that have operations abroad—it is true that they might not be interested from a policy standpoint, since they are not making policy, but they are certainly interested in that they are going to try to think what the policymakers are likely to do, given the data that the policymakers have.

I consequently think it would be a serious mistake for the "liquidity" concept to be dropped from the presentation.

Mr. ELLSWORTH. Thank you, Mr. Holton.

Mr. ANGELL. May I make one point on that, Mr. Chairman?

Senator PROXMIRE. Yes, indeed.

Mr. ANGELL. I would suppose if any central monetary authority bank officer failed to pay attention to the current foreign liabilities, he ought to be fired for incompetency.

I don't know how much the "liquidity" concept serves as a leading indicator in a purely statistical sense, but, as I tried to make clear in my own statement, it is a very powerful indicator of *potential* pressures.

They may not materialize, but the potentials are there and they can develop.

Senator PROXMIRE. Mr. Fousek.

Mr. FOUSEK. Mr. Chairman, if I may. I haven't studied this in great detail, but as far as the business of the early indicator is concerned, the fourth quarter of 1964 is a very real case in point here. We had a deterioration on a seasonally adjusted basis of almost $900 million from the third to fourth quarter on the present "liquidity" concept.

On the "official settlements" concept, we only had had a deterioration of some $300 million. At the time, during the fourth quarter, the U.S. authorities knew that we had a growing deficit, and what was happening here, dollars were going out and being held temporarily in private hands. But the authorities knew they were held temporarily, and in the first quarter of this year the situation was reversed and our gold losses have been very large. In the fourth quarter, the "liquidity" concept showed the true situation much better than the "official" concept.

Mr. ELLSWORTH. I understood what you said, but I am not certain that I follow your every step along the way. I think a number of your intermediate linking points are debatable, but my time is up.

Senator PROXMIRE. I want to get back just a minute to this symmetry concept. Let's take a little harder look at it. We do not include our own private claims, the private claims of American banks against foreign countries, but we do include in this liquidity concept, this Commerce definition, the private claims of foreign banks here.

When we have an inflow of private short-term capital, it does not affect our balance of payments under the Commerce definition. On the other hand, if other countries used the Commerce definition, the liquidity concept, they would have to show that as a deficit. Therefore, these balances would tend to show up as deficits, and you would not have the symmetry, and you would be bound to have a substantial aggregate deficit using the Commerce Department version of the concepts.

Mr. ANGELL. That the Commerce Department practice be changed was one of my points in my earlier, written statement. That's that private, liquid assets should be shown in both our liabilities abroad and our assets of the same sort. In other words, I think the present liquidity definition of Commerce needs some adjustment.

Senator PROXMIRE. Mr. Chittenden had the same kind of comment to make. He said our claims should be made on a discriminating basis because our claims are much less firm and much less reliable than the claims foreigners have here. And I think Mr. Lederer argued that our claims in some of the underdeveloped countries, particularly, are subject to high risk, and therefore, should not be included on the same basis.

Do I understand you to say that you include all claims or would you do it on a discriminating basis?

Mr. ANGELL. I don't think you can do it on a discriminating basis that would make any particular sense. There is no way to do it. However, in this, I don't particularly agree with Mr. Lederer. Put them all in, the liquid claims, on a net basis. That is far superior to the basis of counting some and putting some in that should not be counted.

Senator PROXMIRE. That's how the British handle it, as I understand. At any rate it is now clear that Mr. Bernstein is right in saying that the Commerce definition does indeed result in an overall, international deficit, and a big one.

I would like to ask if Mr. Fousek and Mr. Holton might be willing to comment on this question: The Federal Reserve has emphasized higher interest rates to attract capital. At least, they feel that the short-term rate ought to be edged up a little bit. Its purpose is to attract capital to this country to assist in our balance of payments situation. That's been the whole crux of it. And, as a matter of fact, the Council of Economic Advisers and the Federal Reserve who come up here say the only real argument for a higher interest rate in view of our unemployment and excess capacities is our balance of payments situation. The fact is, under the Commerce definition, when we attract that capital, it does not show up as an improvement in our balance of payments.

Does this make any sense?

Mr. FOUSEK. But what happens? The immediate threat to the gold stock is reduced because either——

Senator PROXMIRE. Maybe the immediate threat is, but it does not show up in the statistics.

Mr. FOUSEK. In the overall concept, it does not, and this is perhaps why a system of two concepts would be helpful.

Senator PROXMIRE. Well, I can see that, unless they would continue to rely on the old one. You know, when you have two concepts—the administration has a great deal of power and influence, and I think perhaps more than any administration that we have had in a long time. They have been trying to get people to buy the concept of the Federal budget on a cash basis, but the people still use the administrative budget. Not much success. They probably will continue to use the old concept.

Mr. HOLTON. Mr. Chairman, if I may——

Senator PROXMIRE. Yes, Mr. Holton.

Mr. HOLTON. I think it is a mistake for us to picture policymakers as using only one figure in this area.

Senator PROXMIRE. Here is the kind of thing that haunts me. We have had a series of decisions made on the floor of the Senate on our participation in international banking ventures and so forth, and our foreign aid program and military assistance programs and while, by and large, the notion of continuing a foreign economic cooperation has continued, it has been seriously threatened by this balance of payments situation as defined by the Department of Commerce.

Some of the most able members of the Senate are concerned over the balance of payments, and they should be. They are using without any modification whatsoever the gross figure, the figure reported by the Department of Commerce now without any adjustment or evaluation in terms of what has been brought out in these hearings, not only this morning, but before that, and I am just concerned that they will continue to do that. And after all, Congressmen and the Senators have a decisive influence in the policymaking.

Mr. HOLTON. I would quite agree with all you have said, but I would go on to argue that it is not, as I conceive the role of a Government statistical agency, it is not the role of such an agency to make this kind of decision for the users. The users, rather, must make this decision for themselves.

Mr. ANGELL. What is involved is a policy choice again, as to how much foreign aid is worth how much deficit. The statistics themselves don't affect that decision.

Mr. HOLTON. That's right.

Senator PROXMIRE. But the statistical figure is the heart of it. Let me say this to Mr. Holton—he may want to reply to this: I am very much aware and I am delighted that you did stress the importance of statistical information. This committee is deeply aware of it. I think you are perfectly right to indicate the relatively modest cost, in view of the immense benefit that policymakers can have. As you say, one-third of one-thousandth of 1 percent of gross national product is involved here, and that tiny investment would, obviously, have a profound effect. We have made very serious errors in the past of various kinds, in monetary policy and fiscal policy which could have been corrected if we had better information.

I would just like to call to your attention that, in our hearings that were just concluded a month ago on the wealth data, the committee vigorously encouraged the administration to go ahead with gathering new kinds of data that would provide an added dimension in economic policymaking, although the cost might be several million dollars, and may be as much as $15 million or $20 million. Committee members who were here for the hearings felt it was a good investment.

Similarly, this balance of payments information is vital. There is no reluctance on our part. But we feel we have some responsibility to determine what it will cost, and if you people urge a change, as Mr. Bernstein did, that involves additional expenditure, you should justify it and document its justification, not just from our standpoint, but we have to sell it to the Appropriations Committee and we have to sell it to both the House and the Senate.

Mr. HOLTON. I quite appreciate your position on this, Senator.

Senator PROXMIRE. Let me ask one other question on publishing of several balances. Publishing several other balances implies that the public must regard different levels of various deficits as normal. I would like to ask how they can reach a judgment of this kind when even our expert witnesses have not been able to do so.

(No response.)

Senator PROXMIRE. Let me put it this way—if you gentlemen don't want to answer that question—let me ask you this, and maybe you won't want to answer this: Suppose you had to indicate a priority on the "official transactions" or "liquidity" concept, and you wanted to put them in first or second place. You can't tell me they are in a dead heat. Which one would you prefer if you could only have one?

Mr. HOLTON. Mr. Senator, I think debate along this line has some disturbing parallels with the debate about what level of unemployment should be the goal, and what is a normal level of unemployment. So many times, actually, we are concerned about the directions of changes rather than absolute levels. But I should think that in this debate, though, we would be helped a bit by having the official settlement version provided, and if we can get the official settlement version to include solid data, then perhaps a zero deficit should be our goal. We would not be prepared to say that the deficit ought to be zero on the liquidity concept.

From what I know of this problem and the figures I have worked with, it does look as though the $500 million to $1 billion figure that Mr. Bernstein emphasized would be appropriate.

Mr. FOUSEK. Mr. Chairman, I can only go back and say that the sophisticated users, the sophisticated analysts in this area have to try to educate the public on the purposes and meanings of both these concepts. Just because a single number would be the easiest shorthand to use, it would still be unsatisfactory. There is no easy solution to this. We have to use several concepts, and we have to try to educate people as to what they mean.

Senator PROXMIRE. I am asking you, if you will—of course, you don't have to answer the question—if you will, to indicate your priority.

Mr. FOUSEK. If I were put in a corner, and under the present circumstances, due to the key currency role of the dollar, I would have to opt for the liquidity concept, perhaps with some modifications, attempting some modifications along the lines I suggested in my written statement.

Senator PROXMIRE. Mr. Angell.

Mr. ANGELL. If you turn to page 2, column 2 of the report, you will find the report is very clear in submitting the argument that no one figure can do the job. I take the same position. I think what Commerce wants all of us to do is to be honest: Both should be explained to the public. There is no use in trying to force one figure alone. You might have a gold surplus of $1 billion, and a deficit on private, liquid accounts of $2 billion. Both of these facts are important. No one figure is by itself adequate.

Senator PROXMIRE. Now, we come down to a precise tie. If you can get adequate data, you are in favor of—Mr. Fousek prefers to see both if he can, but he favors the liquidity concept, and Mr. Angell suggests they both must be published.

Mr. ANGELL. If you put me in a corner—and I don't want to be put in that position—I will take the liquidity concept, too—modified.

Mr. HOLTON. Senator, let me make my position clear on this. I would favor publication of the official settlement version, but for the policymakers, the liquidity concept is preferable.

Senator PROXMIRE. Let me just ask at this point: You suggest the Bernstein report may have underestimated the budget and personnel requirements. What would you recommend?

Mr. HOLTON. Mr. Chairman, I am not prepared to give any estimate on that because I am not familiar enough with the man-hours that are required for some of the specific operations that are suggested in the recommendations. But, certainly, as one looks at those recommendations and sees suggestions of revising benchmarks, of having greater contact with respondents, and so on, it looks to me as though it would take 25 or 30 people at the very least to begin to make headway on this problem. Of course, if you are going to——

Senator PROXMIRE. I'm sorry. Are you a former Assistant Secretary of Commerce? And were you responsible for the budget or for the personnel in this department?

Mr. HOLTON. Yes, and what I am saying is that——

Senator PROXMIRE. When you say 25 or 30, you have in mind the precise jobs that these people would do and the time it would take and so forth?

Mr. HOLTON. More or less. The point I was making is that I don't have a clear conception because I was not actually in the operation, you know, of talking with the respondents, for example, and I am not familiar with the magnitude of the benchmark revision job, to cite another case in point. I don't know just how many man-hours are involved in some of the operations that would have to be carried out if the recommendations of the Bernstein Committee were accepted.

Senator PROXMIRE. None of this would relate to the official transactions concept, would it? The official transactions recommendation is not one that would necessarily, by itself, all alone, require much additional personnel, or would it?

Mr. HOLTON. You are right. To introduce the official settlements transaction balance into the statistics would not be any great problem. Much depends on how long a time period you want to spend in updating the statistics, if you are going out, flat out to have all these recommendations accomplished within 3 years. I am sure 15 or 20 people would not do it.

Mr. ANGELL. Mr. Chairman, if you not only attempt to do the benchmark job the report calls for, but also attempt to alter and improve the merchandise imports and exports and particularly fill up the gaps with respect to tourists' expenses and things of this sort, my guess is it would take 50 rather than 25 or 30.

Mr. HOLTON. The 25 or 30 would be OBE alone. I assume any program for improving the valuation of merchandise trade would be carried out in the Census or Customs, or some combination.

Senator PROXMIRE. Let me go back to the interesting discussion we had in trying to poll our witnesses on which definition they preferred. Let me say that it did not quite come out as it might have seemed because, as I understand him, Mr. Angell does not really prefer the present Commerce definition unless it is modified to include our liquid claims abroad which would be quite a modification from the present method.

Mr. ANGELL. I prefer a modified Commerce definition, but if you come to me to make a choice which I don't really want to make, I would prefer you put it in the concept of the present——

Senator PROXMIRE. Then what you are saying is, if you can get adequate data or get support or a decision in favor of our claims abroad, you would take the present definition; but—a very important modification—to include the American private claims against foreign banks.

Mr. ANGELL. The Federal Reserve Bulletin publishes figures—I don't know how good they are—on our foreign, short-term claims abroad.

Senator PROXMIRE. I am pressing you to tell us, if the decision is between the present system, the present definition, because they just unwisely, perhaps, refuse to include our claims, or the official transactions?

Mr. ANGELL. I would include those claims.

Senator PROXMIRE. As far as you are concerned, you can include them anyway, but you do so by making the adjustment yourself. But this doesn't stop outside nonexperts.

Mr. ANGELL. If you put me in a corner where I don't want to be, I will take the present Commerce definition.

Senator PROXMIRE. One other question: Hal Lary testified yesterday:

> As I understand it, the liquidity criterion, in putting changes in foreign private liquid dollar balances below the line, treats additions to these holdings

as a passive and probably temporary acceptance by foreign banks and other private foreigners of part of the backwash of excess dollars generated by the deficit on items placed above the line.

On the other hand, a much publicized paper by Emile Despres said:

Owing to the unfavorable climate of speculative attitudes, private foreign balances in this country are undoubtedly at a subnormal level in relation to ordinary requirements.

Does anyone care to comment on that?

Mr. FOUSEK. I don't think that I can agree with Professor Despres' statement about these balances being at a subnormal low. I also think that Mr. Lary may be simplifying, if I may say it that way. The private holders of dollar balances are acting from several motivations. Some are held temporarily and may go out again. Some of these are more permanent. It is awfully difficult to say how much is permanent and how much is temporary, but it seems to me there is no doubt, judging from the sharp quarter-to-quarter changes in these holdings, a part is certainly temporary.

Senator PROXMIRE. Does any other witness care to respond?

Mr. ANGELL. I tried in my written statement this morning to spell out the same thing in a little more detail. I think there are, basically, two kinds of liquid liabilities. Some are quite permanent; for example, the working balances of corporations or the balances which American commercial banks require foreign borrowers to keep here. Those stay here. But a lot of other stuff comes in according to current conditions.

I would suggest if all this new money gets provided, the Commerce Department begin an investigation as to the motivation of these liquid capital flows.

Senator PROXMIRE. Let me ask one final question as a summary question: As far as policy decisions are concerned, what difference, if any, does it make how we define the deficit?

Mr. Ellsworth contended—and I thought it had a lot of force—that this decision on definition is going to have a profound effect on policy, whether we like it or not. But I think that it would be very helpful to hear your observations here for the record.

Mr. ANGELL. Mr. Chairman, that's a very complicated question. I would think policymakers—and I am sorry to keep hitting this again—but policymakers would have to know both deficit figures, and they may decide at one particular time whether the important thing is to attract more gold or let it go out, or they may decide it is more important to attract liquid foreign funds. They can't make either decision without having both figures.

Mr. FOUSEK. Mr. Chairman, if I may; as Mr. Angell said, policymakers do have figures for both these concepts and do look at both these concepts and other concepts, too. But to the extent that Government support of all these policies is dependent on one number; and if in a critical situation for the U.S. dollar, the official concept shows a smaller problem, and if the situation is so critical that some action needs to be taken—and we have been through such situations—under those circumstances, I would say that the official concept is likely to reduce public support for administration policies to combat the balance of payments deficit. Under those circumstances, the official settlement concept would be misleading.

Senator PROXMIRE. You mean, the truth may be misleading?

Mr. ANGELL. The incomplete truth.

Mr. FOUSEK. I did say, Mr. Chairman, that if only one number were used, and this number were the official concept, this would give an incomplete picture, and in some situations a very badly misleading picture.

I was thinking in particular of the fourth quarter, for example.

Senator PROXMIRE. You can have a situation where it can be misleading in the other way, and can overbalance our reactions. This can result in international deflation, which can be devastating in our economy and throughout the world.

Mr. HOLTON. I would think even the simplest news story, Mr. Chairman, covering the results of any particular quarter's balance of payments experience, could so easily indicate the official settlements performance plus what has happened with the foreign privately held dollar balances. I cannot really think this would be a serious problem.

As far as the policymakers themselves are concerned, they do not sit down with just one row of figures showing the deficit quarter by quarter on any one definition.

For example, discussions in the last year or two I know have focused on the deficit on regular transactions. In part this was because the deficit on regular transactions was a very helpful measure to indicate what should be undertaken in the way of special Government transactions. But certainly the regular transactions balance was not the only one that was focused on. The others were used as well. And similarly, the analysts, whether they are in the Federal Reserve Board or foreign central banks or private corporations, or private banks, also look at the components of the balance of payments picture, and not just at the single measure.

Senator PROXMIRE. Of course, the term policymakers include others than the Board of Governors of the Federal Reserve Board and the Council of Economic Advisers, et cetera. They include all Members of Congress, they include bank presidents and industrial leaders throughout the country who certainly don't have the opportunity which you gentlemen imply that policymakers would have to have to make this kind of decision between two proffered definitions. They are very likely to be hung up on a figure.

You think that any kind of a competent news story, even if it is simple, does not have much economic background. If you report both figures it is likely to give a better and truer picture to policymakers all over the country.

I'm sure our policymakers would be less well served if we had had more than one estimate for unemployment.

If we used unemployment statistics on the basis that some countries do, counting as unemployed only those who are registered for employment at employment services, we would have a different policy perhaps than if we followed the practice of including as unemployed also those who work part time. These statistics are just immensely important. It is easy for us to underestimate their effects.

Mr. HOLTON. I would quite agree, but I can't really think that the financial writers would have any real difficulty in accommodating themselves to this suggested practice of publishing both balances.

Senator PROXMIRE. Well, gentlemen, thank you very, very much. Your testimony has been helpful, and it is a great service that you have performed to the Congress and to the country.

This concludes the hearings on the balance of payments statistics. As I have indicated, we are going to ask Mr. Bernstein to comment on one or two points that have been raised.

Thank you very much.

(Whereupon, at 12 noon, the hearing adjourned subject to the call of the Chair.)

APPENDIX

Appendix A

The following letter was sent by James W. Knowles, executive director of the Joint Economic Committee, to August Maffry, senior vice president, Irving Trust Co., New York, N.Y., and Robert Sammons, Chief, Balance of Payments Division, Board of Governors of the Federal Reserve System.

June 24, 1965.

Dear Sir: In connection with the hearings of the Subcommittee on Economic Statistics on the report on balance of payments statistics by the so-called Bernstein Committee, the subcommittee chairman, Senator Proxmire, has indicated that he would welcome any additional comments anyone had for the record.

I have been reminded that you were once in charge of the balance of payments statistics in the Department of Commerce and I wonder if you would care to submit, within the next week, a brief statement of your views on the importance of the recommendations of the Bernstein committee, as well as such matters in the report's points as you think deserving of comment.

Very truly yours,

James W. Knowles,
Executive Director.

Irving Trust Co.,
International Division,
New York, N.Y., June 28, 1965.

Mr. James W. Knowles,
Executive Director, Joint Economic Committee,
Congress of the United States, Washington, D.C.

Dear Mr. Knowles: I have your letter of June 24 inviting me to submit a statement on the recommendations of the Bernstein committee. Since Mr. Bernstein had already suggested to me that I might offer a statement, I am sending you a copy of what I have given to him. As you will see, the statement bears on the nature of the claims of foreign commercial banks on U.S. banks. It is intended to be strictly factual, subject to verification by anyone who would take the trouble to examine the files and records of any large New York bank. I had wondered all along why someone involved in the presentation of balance of payments statistics hasn't done this.

In addition to the enclosed statement, let me say that I am in accord with all of the major recommendations of the Bernstein report. I am in accord in particular with the recommendation that changes in short-term claims of foreign commercial banks and other foreign private claims reported by U.S. banks be regarded as ordinary private capital flows. This is self-evident to those of us actually engaged in dealing with such claims.

If I can be of further assistance to the Joint Economic Committee in this connection, I am at your disposal.

Sincerely yours,

August Maffry,
Senior Vice President.

Statement by August Maffry to Subcommittee on Economic Statistics of Joint Economic Committee

The following comments are offered by way of explaining the nature of the claims of foreign commercial banks on U.S. banks.

These claims represent almost entirely necessary working balances as distinguished from what might be considered surplus funds. Foreign commercial banks must keep adequate working balances with U.S. banks for several reasons. The amount of such balances has increased substantially over the last decade and continues to increase in relation to need as explained below.

In the first place, foreign banks require working balances in the United States to meet payments under check drawings, payment orders, payments under letters of credit, and other dollar payments arising out of international banking transactions. Working balances for this purpose are necessary whether or not foreign banks enjoy overdraft privileges with U.S. banks. This is true because foreign banks are not accorded overdraft facilities unless they maintain satisfactory average credit balances with their U.S. banking correspondents.

In the second place, foreign banks require working balances in order to compensate U.S. banks for the cost of handling their transactions in the United States. Careful records based on cost-accounting data are kept for each account to show, on the one hand, the cost of handling transactions for the account of foreign banks and, on the other hand, the imputed return to the U.S. bank on the average balances maintained by foreign banks. If the balances, even though generally adequate to meet payments for the account of foreign banks, are insufficient to cover the cost of handling them, foreign banks are requested to increase their balances in order to put their accounts with U.S. banks on a profitable basis.

In the third place, foreign banks require balances in the United States as a basis for obtaining credit. One of the primary considerations, and often the crucial consideration, in the extension of credit to foreign banks by U.S. banks is balances. This is no academic requirement and is fully understood by foreign banks which are seekers of credit from U.S. banks. Indeed, a very substantial part of the balances of foreign commercial banks in U.S. banks are effectively immobilized for this reason. They are not subject in practice to withdrawal at the option of the foreign banks. This requirement of compensating balances may result in balances ranging from 10 percent to even 100 percent of either standing facilities or outstandings. Furthermore, under either explicit or tacit understandings, a considerable volume of official balances is immobilized in the same way as a basis for credit extended by U.S. banks to the commercial banks of the countries concerned or to other borrowers.

It is well known, of course, that there is some shifting of dollar balances from official holders to foreign commercial banks and vice versa. These shifts occur both at the option of the commercial banks in adjusting their dollar balances to their needs and to local money market conditions and also as a consequence of inducements from local monetary authorities. In the experience of my bank, however, these shifts are relatively infrequent and do not affect materially the balances maintained in the aggregate by foreign commercial banks with U.S. banks. Such balances are of a totally different character than the funds placed by foreign official entities with U.S. banks. The official funds represent largely monetary reserves held in the form of interest-bearing deposits or other short-term investments primarily for the sake of the earnings otained from them. They are generally subject to withdrawal, as the balances of foreign commercial banks generally are not because the latter are indispensable to the conduct of international banking business in dollars.

Statement by Robert L. Sammons on the Report of the Review Committee on Balance of Payments Statistics

I appreciate the invitation of the committee to present, for the record, a statement regarding the report of the Balance of Payments Review Committee. I view with mixed emotions the fact that so much attention has been focussed on the statistics of our international transactions during the years following my own direct connection with their compilation; I suspect that Mr. Lederer yearns occasionally for the good old days when we were more or less free to experiment with various forms of presenting the data without the whole Nation looking over our shoulders. Times have changed, and the balance of payments is now a matter of wide interest to an increasingly well-informed public.

My remarks, of course, represent only my own personal views, and must not be taken to represent the position of the Board of Governors of the Federal Reserve System, nor of its staff.

Since my comments must be brief, I will confine them to those aspects of the report which have proved to be controversial; that is, to the manner of presenting the data and to the related problem of defining the surplus or deficit.

In a comment several years ago,[1] I indicated my belief that official economic statistics should be presented in the most neutral manner possible; that official statisticians should not organize the data, at least not in the principal, or standard, presentation, by which I mean a table like that on pages 128–129 of the review committee's report, or tables like table 1 and table 3 on pages 12–19 of the June 1965 Survey of Current Business—primarily to illustrate the operation of any particular theory of cause and effect relationships; and, above all, that statistical tabulations should not be substitutes for economic analysis. To paraphrase another former Director of the Balance of Payments Division, Mr. Lary, "I would, therefore, urge neutrality rather than direct analytical usefulness for policy formation as a guide to statistical practice."

My preference for the so-called official settlements concept (or rather, for the modification thereof called by the Bernstein committee a reserve-transactions concept) is not, therefore, based on a belief that it is a better measure of the balance of payments than the liquidity or basic concepts. True, if one is forced, or desires, to choose a single measure, I do prefer the one advanced by Dr. Bernstein and his associates, particularly when modified by putting "Special intergovernmental transactions" above the line at which the balance is struck.

But there are several places at which a balance could be struck, and each such balance may be the most useful for a particular purpose. Our concern with international monetary stability forces us to look at a measure that focuses attention on those trends and conditions which, if allowed to proceed unchecked, might make it more difficult, or even impossible, for a country to maintain the rate of exchange of its currency without resorting to direct controls. In other words, we need a measure which equates equilibrium with a general pattern of international transactions which is sustainable over a period of years. But in analyzing the effects of international transactions on the production and distribution of goods and services in the economy, the balance on goods and services is the most important. In measuring the effects on national wealth, it is the balance on current account. And if the effect on international liquidity is of primary concern, there may be no single measure (at least no measure that can be derived from existing data) that is fully satisfactory. Even many persons favoring the present definition of the deficit have indicated a desire to exclude from the measure some of the liabilities to foreigners now placed below the line, such as compensating balances against loans, funds earmarked to guarantee confirmed letters of credit, some Canadian balances considered to be directly related to flows of United States capital to that country, and the like. Aside from the statistical and reporting problems involved, which I think are insurmountable, this would involve classification by motive of the transactor, to which I object.

For there are only two basic ways of classifiying data on economic transactions: by type of transaction, and by nature of the transactor. Classification by basic type of transaction is relatively uncomplicated: goods and services may be exchanged against each other or against capital claims (including money); capital claims can be exchanged against each other or against goods and services; or either can be given or received without a quid pro quo, in which case they may be said to be exchanged against a gift from the transferor to the transferee. Such gifts are usually known as unilateral transfers in balance of payments statistics; more simply just as transfer payments in the national income accounts.

Of course, each of these major groups must be subdivided, if meaningful statistics are to be presented. And the finer the subdivision, the greater the opportunity for ambiguity. Tourist expenditures, for instance, include both goods and services, although it is customary to classify them as services in the balance of payments statement. Capital movements are ordinarily divided into short- and long-term, although the dividing line—at 1-year maturity—is an arbitrary one.

The present data introduce another type classification; namely, transactions in U.S. liquid liabilities to foreigners. Aside from the analytical usefulness of this concept—which has been excessively discussed in the report, and in the statements to, and hearings of, the Joint Economic Committee—the question may be raised as to whether the term is sufficiently precise to justify its use as a criterion

[1] National Bureau of Economic Research, "The Flow of Funds Approach to Social Accounting," Princeton. 1962, pp. 162 ff.

for classification in a system of official statistics. Witness, for example, the problem of classifying U.S. sales of Roosa bonds to foreign monetary authorities in recent years.

Classification by nature of the transactor involves analytical judgments very generally. It makes sense to group economic entities only if it is reasonable to assume that the entities so grouped are, by and large, subject to similar motivations and respond in similar ways to economic stimuli. I consider that calssification by transactor groups is legitimate in the basic statistical presentation, because, although questions of motivation are involved, they affect only the initial definition of groups and not the categorization of individual transactions. Thus, we classify final purchases of goods and services in the national expenditure tables by these four groups of transactors: consumers, businesses, government, and rest of the world.

The controversy surrounding chapter 9 of the review committee's report, it seems to me, basically involves the selection of transactor groups according to which our international transactions can be most usefully classified; most usefully, that is, in the sense of satisfying the largest number of legimate analytical needs without making the presentation too complicated for comprehensive, and without involving the compiler in a need to make judgments about the motive of particular transactions at particular times.

All countries find it useful to classify their international transactions by domestic transactor groups; for countries like the United States and the United Kingdom, whose currencies are widely used internationally, the need also arises for making distinctions between foreign transactor groups.

There is, I believe, no disagreement about the desirability of showing U.S. Government transactions separately; e.g. military expenditures, foreign aid, etc. On the other hand, no one seems to be greatly concerned to split transactions of U.S. residents other than the Government between consumers and business, although, of course, this is done in the national income and product accounts in order to produce integrated sector accounts.

For the reasons adduced by the committee, it seems to me there is great value in showing separately, among transactions in capital claims (including monetary gold) in the balance of payments statement, those transactions involving the assets of a monetary authority, either of the reporting country or of some other country. Such assets, which I shall label somewhat loosely reserve assets include gold and capital claims on nonresidents. The latter may be denominated in either domestic or foreign currencies; claims on residents are not included, even if denominated in a foreign currency. Claims of the monetary authority of the reporting country on nonresidents of that country as well as claims of foreign monetary authorities on residents of the reporting country are included. The determining factor, in this case, is not the character of the debtor but of the creditor.

In a fixed exchange rate system, such assets are the means of payment of last resort, when all other measures of redressing, or if one prefers, of financing, a balance of payments deficit or surplus have been tried and found wanting, or have been rejected as being incompatible with other economic goals. These other measures may involve, or may result in, transactions which may differ only slightly from movements in reserve assets themselves; ambiguity along either side of a classification line is not peculiar to balance of payments accounting. Many different tools are used by monetary authorities to induce private owners of capital, domestic or foreign, to move their funds into or out of a country; subsidized forward cover facilities and high general interet rates are two of them. United Kingdom residents will, presumably, repatriate funds from abroad if bank rate is raised high enough; German commercial banks will do the same if subsidized forward cover facilities are removed or curtailed. In both cases, official reserves will rise. In both cases, it seems to me, it is reasonable to think of the balance of payments deficit as having been reduced (or surplus increased), if one insists on thinking of balance of payments deficits and surpluses in such simple, mechanistic terms at all.

Combining the assets of monetary authorities with those of private commercial banks and others seems to me to do considerable violence to the principle of similar behavior or motivation which is basic to all economic classification systems. Monetary authorities are not primarily motivated by the desire for financial gain in the ordinary sense; their actions are determined by national objectives, and their operations in reserve assets, in the last analysis, by the need to defend the parity of the currency. Commercial banks and other private entities, on the contrary, are motivated by little else than the desire for profits, except under a system of rigid exchange controls (when the private bans can be considered merely to be acting as agents of the monetary authorities). Their transactions in foreign claims therefore, it seems to me, belong above the line with all other private and other nonreserve transactions.

Given the historical and practical considerations involved, I would opt for the committee's suggested form for the main balance of payments table (pp. 128–129). I would, however, prefer the following modifications:

1. Military grants and the exports they finance (memorandum item I) should be included in the body of the table; we are transferring real resources to foreigners out of our current production or stock as truly under the military aid program as under any other aid effort.

2. I would prefer to make line G, short-term claims of foreign commercial banks on U.S. banks, a separate subline in section F, but would regard the committee's suggestion here as, in fact, a reasonable compromise between the liquidity and official settlements points of view.

3. I would, however, by all means eliminate line K; that is, I would transfer line K.1 to section C, where it could, if desired, be a separate subline. Advance debt repayments, like advance payments on military purchases and short-term capital movements induced by monetary policy, may best be thought of as transactions which reduce, rather than finance, the deficit.

This would leave the present line 2, "Reserve transactions," as the principal single measure of the overall position, which, as already stated, is my preference.

Admittedly, even the reserve transactions concept is not without its ambiguities. What arms of a government are to be considered monetary authorities? Not just the central bank, clearly; many countries have stabilization funds, which legally, are part of the Finance Ministry. The transactions of such funds are clearly reserve transactions. Other cases are not quite so clear. If the treasury of a country which has both a budgetary and balance of payments surplus chooses to invest directly in foreign claims (e.g., holdings of Roosa bonds by the Swiss Confederation), is this less of a reserve transaction than if the (budgetary) surplus were deposited in the central bank, and the latter held the foreign claims? Or take the case of a government which deliberately and specifically borrows its own local currency to buy from its own citizens the foreign exchange which they have received, and then invests this foreign currency directly abroad—and all of this in order that the central bank will not have to acquire the foreign exchange and add it to the official reserves. In such a case are the resulting holdings of exchange less a part of the country's monetary reserves than if they had been acquired by the central bank (or stabilization fund) in the normal manner?

Unfortunately, no classification system is completely automatic; judgment of the classifier will always be required, and the judgment of honest men will differ. What I am pleading for is a classification system in the balance of payments that will minimize such differences of opinion, by removing from the system a criterion which at least implicitly involves a judgment as to the motives of a particular transactor in a particular situation; or, if "motives" is too strong a word, a criterion which involves the judgment that he is influenced in a very special way by the policies of the monetary authorities. A classification based on only two criteria—two quite objective criteria—the nature of the transaction and the general, or customary, nature, or economic group, of the transactor is all that the official compiler should be called upon to produce. The rest is analysis.

APPENDIX B

A SUPPLEMENTARY NOTE ON THE BALANCE OF PAYMENTS STATISTICS

(By Edward M. Bernstein)

A number of witnesses before the Joint Economic Committee have made the point that the measurement of the deficit by official settlements does not properly present the payments position of the United States, because the accumulation of liquid dollar assets by foreign commercial banks, foreign firms, and foreign individuals represents a potential drain on the reserves of this country. Furthermore, instances are cited where banking claims of foreign commercial banks are owned by central banks, either immediately or under forward exchange agreements.

It is important to note that the present method of presenting the balance of payments in which the deficit is measured by the increase in U.S. liquid liabilities did not come into use until the mid-1950's. When this method of presenting the balance of payments was introduced, it was defended on the grounds that virtually all countries had exchange control and that the monetary authorities could acquire the liquid assets of their nationals at any time. When the world was concerned about a dollar shortage, there may have been some justification for the concept, although actually the dollar shortage was over by then and countries were liberalizing the right of their nationals to hold dollar assets.

When the inclusion of U.S. banking liabilities to foreign commercial banks and other private foreigners as part of the settlement items was challenged on the grounds that similar claims by U.S. banks and nonbank concerns were regarded as capital outflow, the asymmetry was justified because it was alleged that the foreign claims of U.S. banks were not really liquid and that the short-term claims of U.S. nonbank concerns could not be brought home if there were a deterioration in the balance of payments. The present program to reduce U.S. private capital outflow shows conclusively that it is possible for banks to reduce their claims on foreigners, whenever this becomes necessary. Furthermore, it shows that the short-term claims of U.S. nonbank concerns in foreign money markets can be liquidated and the funds repatriated. There is no practical difference between private foreign claims on our money markets and U.S. banking and other money market claims on foreigners. Neither the former nor the latter are, in fact, settlement items. They are capital movements. Such transactions are undertaken primarily because they meet the business preferences of U.S. banks and nonbank concerns that hold claims on foreigners and the business preferences of foreign commercial banks and other private foreigners that hold claims on the U.S. money market.

In the testimony before your committee, some witnesses now justify the inclusion of the liquid dollar assets of foreign commercial banks and other private foreigners in the settlement items in the U.S. balance of payments on two new grounds. The first is that in fact a considerable part of the holdings of foreign commercial banks is beneficially owned by central banks, either through deposits made with banks abroad or through forward exchange contracts under which they sold dollars to their commercial banks, as an investment for these banks, with the obligation to repurchase the dollars in the future.

One piece of evidence cited as proof that foreign central banks must hold large amounts of dollars not reported as U.S. liabilities to foreign monetary authorities is the difference between the reserve figures reported by countries to the International Monetary Fund and the figures published by the United States and the United Kingdom as liabilities to foreign monetary authorities. An analysis of the data by the statistics department of the Fund shows that this discrepancy is almost entirely due to differences between reserve liabilities in sterling reported by the United Kingdom and reserve assets in sterling reported by certain countries in Asia. The source of the difficulty is that some holdings of sterling by certain Asian Governments were not classified as liabilities to monetary authorities by the United Kingdom, while the Governments concerned did regard them as reserve assets. In the opinion of the Fund statisticians little of this discrepancy is due to a difference between the dollar reserves reported by foreign countries and the U.S. report on liabilities to foreign official institutions. While some confusion does arise from the fact that some countries do and others do not include Roosa bonds in their reported reserves, this would not affect the balance of payments on an official settlements basis which classifies all Roosa bonds as reserve liabilities.

Definitely the large discrepancy between reported reserves and reserve liabilities does not come from the holding of Eurodollars by foreign central banks. No doubt some central banks hold Eurodollars, although such holdings have become very small in recent years, as central banks in Europe are aware of the undesirability of holding reserve funds in the Eurodollar market. In any case, if such funds are held by foreign central banks in Eurodollars, they are not a reserve liability of the United States and should not enter into our balance of payments. They are an obligation of the Eurodollar bankers abroad who cover themselves by making dollar loans to other foreign countries and holding a reserve of dollars for working balances in this country.

At the end of December 1964, the total Eurodollar deposits in London were $4,380 million. These were matched by claims against foreign countries of $3,700 million. A considerable part of these claims, $1,200 million, was against the United States, mainly U.S. banks, with much of this amount representing Eurodollar deposits transferred by London branches of U.S. banks to their head offices. Thus, only 28 percent of the Eurodollar deposits were represented by U.S. liabilities. Even if there were some Eurodollar holdings by central banks, it would be a mistake to attribute the liabilities of U.S. banks to foreign banks accepting Eurodollar deposits as in any sense liabilities to foreign central banks. Incidentally, the claims of U.S. firms on the Eurodollar market, directly and through Canada, exceeded the liabilities of the United States to Eurodollar bankers at the end of 1964.

A more plausible case can be made for the argument that forward exchange transactions under which foreign central banks sell dollars spot and buy dollars forward from their own commercial banks should be regarded as U.S. monetary liabilities of an official character. Nevertheless, it is not correct to treat contingent transfers of this kind as part of the present balance of payments. The foreign commercial banks buy these spot dollars because their earnings from dollar assets plus the premium on the forward transaction offers them a very good return. For them it is a profitable investment and it should be treated as capital inflow.

The articles of agreement of the International Monetary Fund, which is designed to help countries finance their payments deficits, state (art. V, sec. 3(a)(iv): "A member shall not be entitled without the permission of the Fund to use the Fund's resources to acquire currency (from the Fund) to hold against forward exchange transactions." This is because the Fund does not regard forward exchange transactions as part of the actual deficit. These forward commitments may or may not materialize in the deficit when the forward contracts for sales of dollars by foreign commercial banks become due. The transactions may be reversed. They may be offset by other maturing forward transactions requiring the purchase of dollars. If they do finally involve net transfers of dollars from foreign commercial banks to foreign central banks they will then be shown in the balance of payments.

Perhaps the most difficult case is where the U.S. monetary authorities themselves enter the forward market to sell foreign currencies for dollars. This induces foreign commercial banks to hold more dollars because it is profitable. But the U.S. monetary authorities do have a contingent liability to provide foreign currencies when the forward contract matures. Here, too, the important point is that the forward contract is entered into at a time when there is capital outflow which may be reversed. Such a forward transaction is not very much different from attracting foreign funds through higher interest rates. After all, the forward contract is a way of providing an interest rate inducement to hold dollars, although the higher return is confined to certain foreign holders of dollars. The experience is that these forward commitments get liquidated in time. The amount outstanding does return to zero.

If there were full knowledge of the amounts outstanding on forward exchange contracts entered into by the monetary authorities of all countries, it is by no means clear that these would ordinarily show an adverse position for the United States. After all, foreign monetary authorities do enter into contracts to sell dollars forward as well as to buy dollars forward. It is almost certain that at the end of 1964 the forward commitments of monetary authorities to sell dollars were far larger than their forward commitments (including those of the United States) to buy dollars. To the extent that the Treasury and the Federal Reserve have knowledge of such forward commitments, they should be used in the analysis of the balance of payments. They are not, however, a part of the actual transactions that should be recorded in the balance of payments. Above all, they are not a justification for including as liquid liabilities of a reserve character the $7 billion of short-term dollar holdings of foreign commercial banks.

The New York bankers informed the Review Committee for Balance of Payments Statistics of the United States that holdings of dollars by foreign commercial banks and by other private foreigners are necessary as working balances. They pointed out that these balances determined the amount of their lending to foreign governments, foreign banks, and foreign companies. They emphasized that a drawing down of these balances would be followed by a reduction of bank credit to foreigners. At the end of 1964, the short-term banking liabilities in dollars amounted to $7,153 million to foreign banks and $3,354 million to other foreigners, excluding official institutions and international and regional organizations. The essentially business character of these holdings, against which U.S. banks have short- and long-term claims of more than $11.7 billion, is in no way impaired by the argument that at certain times (but only for short periods) as much as $1 billion of these funds are held by foreign commercial banks under forward exchange contracts.

No set of data can be free of conceptual problems. Perhaps there are some foreign private holdings of dollars that should properly be included in official holdings, and thus regarded as reserve liabilities. By the same token, there are even larger amounts included in official dollar holdings that are fully offset by the direct and indirect liabilities of certain central banks to U.S. banks. At the end of March 1965, the dollar assets of the Japanese Government and banks in the United States amounted to $2,776 million; but Japan's short-term dollar liabilities to U.S. banks were $2,842 billion, apart from long-term liabilities to U.S. banks of $468 million. A similar situation exists in a number of large Latin American countries where U.S. banking claims exceed the dollar assets of the monetary authorities and the commercial banks. These countries are not in a position to convert, or even to draw down to a significant extent, their official holdings of dollars. In the aggregate, these immobilized official holdings of dollars are large, certainly much larger than any sums classified as commercial bank holdings that should properly be treated as official holdings. Given our present data, there is no reason for departing from the principle that reported foreign official holdings of dollars should be treated as foreign monetary reserves, and reported commercial bank and other private foreign holdings of dollars should be treated as working balances and short-term investments; that is, as capital inflow.

A new and irrelevant argument has recently been presented in favor of the liquidity concept. It is now claimed that the inclusion of changes in commercial banks and other private foreign holdings in the deficit gives us a leading indicator of what will happen to official settlements. The balance of payments should not be set up to act as a leading indicator, but to record as accurately as possible the international transactions, private and public, current and capital, which actually takes place. There is no more reason for transforming the balance of payments into a leading indicator than there is for transforming the index of industrial production from a record of actual output to a leading indicator, say, by including new orders.

Obviously, the balance of payments must be thoroughly analyzed to determine the causes of any deficit and to weigh the consequences of any measures to restore the U.S. payments position. An important part of such an analysis should be the study of the behavior of the dollar holdings of foreign commercial banks and of other private foreigners. The analysis of this sector of the balance of payments has been neglected precisely because the present method of setting up the balance of payments has treated such holdings as settlement items. Instead of being regarded as having dynamic characteristics of their own, responding to economic conditions and monetary policy in this country and abroad, they have been regarded as the passive result of the behavior of other items in the balance of payments. No economist can be satisfied with a predetermined analysis which assumes that private holdings of dollars are merely a way station to their ultimate acquisition by foreign monetary authorities. The 2 years in which the United States had the greatest gold outflow (1950 with $1,743 million and 1958 with $2,275 million) were preceded by periods in which the increase of private dollar holdings was negligible—$54 million in 1949 and $274 million in 1957, of which only $51 million was in commercial bank holdings.

It is now accepted even by those who advocate the liquidity concept for measuring the balance of payments deficit that it does not give us a quantitative measure of the payments problem; that is, the amount of improvement that would give us a satisfactory balance of payments if maintained on an average over a period of years. It has been widely assumed that the proper deficit is zero (even by the present definition) and that the United States must eliminate the payments deficit in order to have an appropriate longrun payments position. The review committee has stated that the present deficit grossly overstates the magnitude of the payments problem and that a deficit of zero would be about right, provided that the deficit were measured by official settlements. Although Mr. Chittenden supports the present definition of the deficit, he does agree that it has a bias. "I would put the deficit bias at between $500 and $800 million and argue that this should be a tentative target at which to shoot."

I accept Mr. Chittenden's conclusion that there is a bias in the present measure of the deficit, but I cannot accept his reasons for retaining it. The analogy with the budget and the unemployment figures is unconvincing. I do not see how the justification for a budgetary deficit in a period of less than full employment can be used to support the argument that the proper measure of the balance of payments must always involve a deficit of $500 to $800 million—the variation within this range being determined by some rule of thumb. Nor do I see how the argument that there must always be a positive level of unemployment which is acceptable can possibly support the view that the proper way of presenting the balance of payments is to show a deficit of $500 to $800 million when there is no payments problem.

The real trouble with Mr. Chittenden's arguemnt, as with the present measure of the deficit, is that it depends on a quasi-analytical approach for a measure of the deficit. The proper measure of the deficit is the amount of official settlements which is an experienced reality, and which cannot be negative by a considerable amount or for any considerable length of time without seriously impairing the reserve position of the United States. If we want to know why a deficit has occurred, we must analyze all the accounts, including those showing U.S. bank credit and other capital outflow, and foreign private deposits and other capital inflow. Certainly, we must know why private liquid assets have increased much or little, and whether such holdings will continue to grow or decline. But it is no substitute for such an analysis to put private foreign dollar holdings in the settlement items of the balance of payments.

It is some progress to have it clearly stated that the way the U.S. balance of payments is now presented, we should expect a normal deficit of $500 to $800 million. I venture to say that this is not enough. When the U.S. payments position is being discussed, compared, and analyzed, it will be far more useful to start with official settlements under which a normal deficit over a period of years would be about zero. The Bank for International Settlements shows the U.S. balance of payments on an official settlements basis in its report for 1965 (p. 7). It shows the world balance of payments for three areas—the United States, Western Europe, and the rest of the world—on the same basis (p. 79). The financing of the U.S. balance of payments deficit is shown in the BIS report by starting with the balance on regular transactions, making the adjustments necessary to arrive at the balance on an official settlements basis, and then presenting in detail the reserve and other official transactions by which the deficit was settled (p. 116).

The U.S. balance of payments must be presented in a realistic way, in a form that facilitates analysis of the constituent accounts and comparison with the balance of payments of other countries. Little is accomplished by the warning that the U.S. balance of payments, as now presented, overstates the payments problem by $500 to $800 million a year—although such a warning is essential if the reported deficit is not to be wholly misleading. The next step should be to present the balance of payments on an official settlements basis. However, in order to assure continuity in the data, the reconciliation with the deficit on regular types of transactions should also be shown. Above all, we must have a thorough analysis of all of our balance of payments accounts, instead of the simple assumption that private holdings of dollars are not here to stay, but will somehow, sometime be passed on to the monetary authorities.

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