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Rehabilitation of Balance of Payments

by Dietrich Kebschull, Hamburg

For the United States, the new year began with a bang. In his New Year's Message President Johnson jotted down "tough measures" for an elimination of the balance of payments deficit, measures that in part are completely opposing the hitherto existing liberal economic policy. These measures have by no means been taken unexpectedly, since for years already, the solution of the balance of payments problem is one of the most important tasks of American economic policy. Although hitherto only palliatives were mainly applied, this way a devastating deterioration of the balance of payments could be avoided to a large extent. The deficits for 1966 amounted to but \$ 1,300 million.

Growing Balance of Payments Deficit

However, speculation around the dollar—setting in due to the pound sterling devaluation—and the gold outflow connected with it caused the balance of payments deficit to grow considerably. The past year ended with a deficit of approximately \$ 3,500 to 4,000 million. The last quarter alone should show a deficit of about \$ 2,000 million. Measures suited to stop the continuation of this development and to protect the economy as well as the international monetary system were therefore unavoidable. The new programme is determined mainly by an improvement of the balance of services and capital transactions and is additionally flanked by some measures aiming at an increase of exports of goods and an improvement of the domestic economy. The Administration believes thus to be able to reduce the current year's deficit by \$ 3,000 million—an estimate, it is true, that in view of the many prerequisites and imponderabilia seems to be an extremely optimistic one.

The limitation of American direct investments abroad is the most important item of the programme as regards opportunities of savings. In future all capital exports to continental Europe, with the exception of Greece and Finland, are subject to a moratory. There are no exceptions but for investments, that do not surpass 35 per cent of the amount invested on an average during the two preceding years (transfers of capital and reinvestment). For a second group of countries—Canada, Japan, Britain, Australia and the oil-producing states—all of which maintain particularly close relations with the United States, this quota is 65 per cent, and for developing countries 110 per cent. Simultaneously the transfer of profits of American enterprises is to be maintained on the last

years' level. This way a relief of the balance of payments by \$ 1,000 million is believed to be possible.

Here the developing countries clearly seem to be favoured. Their special treatment can be justified politically and economically. But it may be doubted that American private enterprises will increase their investments just in these areas. For, the level of investments is determined, apart from opportunities for profits, above all by the probability of risks being particularly high in these countries. In addition many investments are not possible without supplementary government projects. The reduction of state development aid funds just undertaken is hardly suited to promote the American companies' propensity to invest in young states.

Export Losses through Investment Cuts

The European nations might welcome this decision. For, not only France time and again expressed itself against the danger of an American control of the country's economy and a limitation of foreign investments. In this connection, however, it is easily ignored that US investments are quite welcome in less industrialised regions. The absence or a major reduction, respectively, of investment activities should have disadvantageous effects on the development of these regions' employment and income situation, and via a decrease of effective demand also impair the demand for foreign goods. This effect will be additionally intensified by the fact that subsidiaries as a rule will have very close relations with the parent company and the country where the latter is located. The bigger the number of establishments abroad, the more exports will grow. Thus together with a cut of possible American investments abroad, determined solely by the development of the capital balance, future export chances will be simultaneously limited—without doubt in an unwelcome manner.

The effects of investment restrictions on the balance of capital yields must not be ignored. In the long run the return flow of profits and dividends growing due to increasing investment activities abroad should improve this balance strongly and make it a counterweight to the present deterioration of the capital balance. The limitation of investment, obviously undertaken mainly under short-term aspects, so far obstructs the long-term improvement of the total balance of payments.

Only such investments are excepted from this limitation, that can be financed in the host country's

capital market. But at least in Europe, the chances for such financing are very small due to the anyway pronounced financial drain to the capital markets, above all by the governments. Besides it cannot be excluded completely that some states will close their capital markets against American companies, as due to the interest equalisation tax they themselves do not have the opportunity of such financing in the United States.

Difficulties in Practice

A fine of up to \$ 10,000 may be assessed for contraventions of these regulations, and besides they may be prosecuted under the penal law. An extensive bureaucratic organisation would therefore be required for control purposes—for investigations alone, whether quotas are being complied with. Any doubts are justified that the six control officers as planned for will be able to handle the work awaiting them. They should share the fate of many similar departments projected on too small a scale, which have to confine themselves to daily routine work without finding time for the investigations proper. Moreover, for the time being, clear comments of the industries involved are not yet available. Economically the fines provided for should hardly be a serious obstruction to investment activities in view of good long-term chances of profits. Legally already the effecting of an interim injunction through an individual entrepreneur's action to void the bill as unconstitutional would suffice to endanger the rehabilitation programme at least for this year.

Voluntary Guidelines for Foreign Credits

In contrast to the legal limitation of direct investments the measures for a reduction of foreign credits, through which this year a total of \$ 500 million is to be saved, are only "voluntary guidelines". According to them, short-term bank credits for continental Europe—as far as they do not serve the financing of exports—are to be reduced by a total of 40 per cent as compared with the preceding year. Even in this case they must not amount to more than 103 per cent of the credits outstanding at the end of 1964. The prolongation of long-term loans is completely prohibited. Corresponding regulations are valid for the other finance companies, that, moreover, have to liquidate their short-term foreign assets.

Although the American banks and finance companies reacted negatively to this part of the programme, there is hardly any doubt that they will adhere to the guidelines. For, any time the Administration has the opportunity of enforcing its ideas with tougher means of coercion. As for Japan, Canada and Britain special regulations are provided for, savings are almost exclusively to be borne by continental Europe, although the flow of commodities should be but slightly impaired with that. For, the financing of exports remains excluded from the regulations.

The improvement of the balance of services is supposed to occur in two ways. For one thing the United

States hopes for higher direct or indirect contributions to the stationing of its troops. For another, American private citizens are to forego all not absolutely necessary trips abroad. Both measures are to effect savings of foreign exchange to the tune of \$ 500 million each. But also the informative visits of the Under-Secretaries of State, Katzenbach and Rostow, following immediately upon the President's declaration, will hardly cause the allied states to contribute more to the financing of the American contingents of troops. For, in spite of their readiness to support the United States the European governments are handicapped owing to budgetary difficulties existing everywhere. And Federal Chancellor Kiesinger will hardly be prepared to make extensive promises in respect of the purchases of armament supplies and securities similar to those of his predecessor, Herr Erhard. For these promises contributed decisively to the present budgetary troubles. In any case the American wishes in this field have to be the subject of internal NATO negotiations whose results remain more than uncertain.

Particular difficulties are caused by the limitation of tourist traffic. Legal possibilities for such a limitation do not exist as yet. But the appointment of Secretary of State Fowler to investigate ways and means for a legal improvement of the balance of tourism makes it clear that the Johnson Administration does not shrink back from taking thorough measures even in an election year. However, the creation of legal prerequisites does not guarantee success. In some European countries the proceeds from American tourism, amounting to a total of \$ 800 million last year, are an important item. Their reduction or elimination, respectively, results in a decrease of domestic demand and may lead to a lower demand for foreign goods and to reactions that will finally handicap American exports.

The Export Promotion Programme

The widely announced export promotion programme is thus limited from the first. The short-term improvement of the balance of trade by \$ 500 million should, moreover, be hardly possible also owing to the limited applicability of the individual measures. For, the improvement of export financing and insurance conditions should lead to quick reactions of other exporting countries and suffice alone to cause a general contest of terms of trade in which finally none of the parties concerned will gain considerable advantages. Since undisguised subsidies and fiscal promotion measures may only be granted within narrow limits, the initiatives should concentrate mainly on the so-called "traditional" promotion measures, which, however, will become effective after a prolonged starting period only. This is above all a problem of enabling individual companies and groups of enterprises to become exporters and then to support them in initiating and winding-up business transactions.

However, these measures, too, can only be effective if the United States does not merely want to export but at the same time liberalise its imports. But at

present everything seems to indicate that the existing protectionist tendencies will not decline in future but will rather increase still. Other nations' counteractions then to be expected would abolish the export targets.

Neglect of Domestic Rehabilitation

It is common to all these measures that they do not eradicate the grievance of the balance of payments misery but confine themselves to a curing of balance of payments items in respect of which savings are to be hoped for soonest. But the United States' balance of payments troubles neither result mainly from exaggerated investments abroad and foreign credits, nor from too much tourism or too low exports. They are rather caused above all by the country's manifold economic and political obligations as a world power. A truly effective policy for the rehabilitation of the balance of payments ought to take these facts into consideration. Moreover, corresponding measures for a domestic rehabilitation are required for its supplementation. Only if the domestic situation allows for sufficient opportunities for profits, direct investments will be made in the United States in the long run and credits to a large extent will remain in the country. Stable prices are as well a most important prerequisite to a permanently effective export promotion policy.

The most recent tax bill and the plans for a reactivation of income policy should hardly suffice to achieve stabilisation as long as a vast government budget permanently initiates inflationary tendencies.

The measures planned now are to the disadvantage of the allies. Their effect is by no means secured. Besides it may be assumed that they will scarcely remain restricted to two years but like all protectionist interferences will show a tendency to stay.

This would not remain without influence on the future development of the world economy. For, after the United States for nearly 20 years advocated the ideas of free trade with an almost missionary zeal, in a case of emergency the country turned to measures of old-fashioned protectionism.

Thus the United States followed the example given by a growing number of other highly developed countries. In spite of all professions to the ideas of free trade and free capital movement, measures in conformity with free trade, that are difficult to operate, did not yet assert themselves. Johnson, too, adopted the easiest course with his new programme. The protectionist undercurrents—not so weak anyway in the Western world and particularly in the United States—will hardly weaken this way.

INTERNATIONAL AID

Targets, Commitments and Realities

by Professor Dr Hans W. Singer, New York *

By solemn resolutions of the United Nations, both in the United Nations themselves and in related organisations such as UNCTAD, the industrial countries of the world have accepted a commitment to provide aid to the developing countries of at least 1 per cent of their national incomes. It may be noted that this commitment was accepted, in voting at least, both by the Western and the Eastern group of industrialised countries. The Western industrialised countries have not only voted for this commitment, but they have further and voluntarily re-affirmed it in the Development Assistance Committee (DAC) of the OECD in Paris, and they are seeking and debating detailed ways of carrying out this commitment.

The commitment is impressive. It certainly represents a new departure in international economic relations, and most of us would welcome it as a sign of hope and promise.

Problematic Definitions

However, a number of questions immediately arise. Most obviously, there is the problem of how to measure the target itself and its fulfillment. There are some

questions concerning the denominator of the 1 per cent ratio, i.e., the national income of the aid-giving country. There are several national income concepts—net income and gross income, domestic and national income, etc.—developed by national accounts statisticians. These difficulties are, however, quite minor compared to the difficulty of measuring the numerator, i.e., the amount of aid given to developing countries. There, a minor difficulty arises in connection with the definition of "developing country". The OECD definition for example, differs from the United Nations definition. There are obviously borderline-cases. Is Greece a developing country? Is Israel? What about Spain and Portugal? However, the really important difficulties arise in connection with the definition of "aid". What is aid?

The widest possible definition of aid would make aid identical with all transfers of resources to developing countries. Private investment, export credits, aid to close military allies, commercial loans at 6, 7 or 8 per cent per annum—all would be included in aid. Moreover, a maximum definition of aid would measure aid flows on a gross basis, that is disregarding amortisation of previous resource transfers, let alone interest payments and reverse capital flows from the

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