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## World Trade

# The US Economic Contribution in 1969

by Professor Dr Robert G. Wertheimer, Cambridge/Mass.

**T**he 55th National Foreign Trade Convention held in New York last November reflected Republican expectations of an end to mandatory controls over direct foreign investment and of cooperation with foreign nations that would remove all discrimination and major currency disturbances. While a continued US balance of payments deficit of \$1 billion was not declared anathema, the emphasis on a sound dollar, due to domestic anti-inflationary measures and a balanced budget, was overwhelming.

### **The General View Ahead**

The dismantling of controls dealing with international trade and finance will become a principal concern of the New Administration, views fully shared by the business community. There is full agreement that the principal culprit causing international controls and distortions is domestic inflation. It must be attacked to achieve pricing and wage policies consistent with gains in productivity and a balanced federal budget with more slowly rising expenditures than in the past. While international trade and finance are to be expanded, the agreements of the Kennedy Round have led to rising disappointment because many of the tariff reductions become meaningless in view of continued discrimination against US imports. Hence, forces demanding specific protection and retaliation against all non-tariff obstacles such as border taxes are rapidly growing. Particularly sensitive is the agricultural export sector in its frustrations how to cope with Common Market levies. In dealing with the balance of payments, business calls for a reversal of the inflationary trend which alone can make it possible to match international competition and restore to the dollar all traditional freedoms. Neither gold nor the European currency problems in connection with the French franc crisis weigh significantly in the expectations that effective international manage-

ment can remove all threats of any new crisis. When the Treasury Secretary-designate Kennedy recently used the term "I'm keeping open every option" he did not want to inject uncertainty as to the position of the New Administration with regard to the price of gold, exchange rates, etc., but only to emphasize in line with the Presidential instruction that no positive statement as to new policies would be made prior to the Inauguration on January 20, 1969. In terms of the price of gold and of many other international matters, the New Administration will follow 100 per cent and with the same insistence the well familiar standards of the past. Incidentally, concerning the price of gold, the President as the executive has no constitutional powers to change it and the democratic Congress has not given the slightest indication that the strict \$35,— price per ounce would ever be changed.

### **The Dollar**

The dollar enters 1969 as a much stronger currency than in recent years. Significantly, this strength in international exchange markets is not due to a genuine improvement in the US balance of payments but to a shift in the general world situation. The liquidity deficit (as a rule, this type of calculation makes it the largest possible) declined to \$1.6 billion in 1968 against \$3.6 billion in 1967. This improvement, however, is chiefly due to large capital inflows and US parent banks borrowing from foreign subsidiaries. The capital inflow consisted not only of flight capital due to rising political uncertainty in Europe but also of speculative funds moved to the US for appreciation in the booming economy and stock market. The renewed confidence in the dollar is also the result of a more realistic expectation of the end of the war in Viet Nam, and related financial drains as well as the end of the deficit in the federal budget by April 1969.

The international monetary system will remain based on fixed exchange rates and the two-tier gold price system which is expected to work well. The New Administration will not agree to flexible exchange rates, not support a higher price of gold or propose its demonetization. In any case, the burden of proof in adopting the former, as Mr Hayes, President of the Federal Reserve Bank of New York put it before the Conference, is on the proponents of such change and there has been no support of changes in the gold position by the monetary authorities at home and abroad. However, the main battle for the soundness of the dollar—domestic and international—still has to be won. The inflationary spiral, leading to a 4 per cent rise in consumer prices in 1968, an upsurge of land prices—houses in Washington today are quoted 80 per cent above the prices when the last Republican Administration ended in 1960—and a rapidly growing preference of investors for equities over fixed income securities, must be ended. As long as the outlook for world trade and investments remains optimistic and major countries are willing to cooperate and check short-sighted nationalism, the dollar will remain the most wanted financial instrument. In a climate of stability, neither devaluation nor up-valuation nor floating exchange rates or a major change in the role of gold, have any place. The Secretary of the Treasury already has rejected any tinkering with the fixed price of gold because this would be “inflationary and confidence-shattering and too great a price to be paid for the resulting gain in liquidity”. World trade, according to him, must continue to expand but to do so something other than gold or dollars have to be added to reserves. Paper gold as a supplement remains a favorite but still larger monetary resources must be made available by all, the Monetary Fund, the Ten and swap and special lending agreements.

### **The Balance of Payments**

In spite of the significantly smaller deficit in the US balance of payments amounting to \$1.6 billion in 1968, this was a year of most unexpected and disconcerting development in merchandise trade. According to trade statistics so far calculated, the surplus on the merchandise balance will have shrunk to \$1 billion against a usual surplus of \$4 billion. Under normal conditions, a creditor nation such as the US with net foreign claims over liabilities exceeding \$50 billion, is expected to run a merchandise deficit to enable foreign debtors to finance their obligations. The great strength of the English pound until 1914, for example, was based on the mechanism of a typical trade deficit. Today, the new items in the balance of foreign defense and aid spending have made meaningless this kind of balancing. The US needs large surpluses in the merchandise

and service balance to finance its international obligations.

The disappearance of the merchandise surplus in 1968 had no mysterious reasons such as “a collapse of our ability to export” due to domestic inflation or a switch in our traditional export-mindedness to operations in world markets through foreign subsidiaries. Nor did something worse happen—a decline in US ingenuity as a dynamic producer of newly-wanted products in world markets. Actually, what did happen was that US exports continued their steady growth from an average of \$31 billion in 1967 to 34 billion in 1968 or by 9.6 per cent, and this in spite of faster rising export prices than those of Western Europe (with an advance by 12 per cent versus 3 per cent since 1963). The explosion occurred on the side of imports which climbed from \$27 billion in 1967 to 33 billion in 1968 or by 22.4 per cent. This sharp increase was due to various factors: inventory hoarding of steel and copper due to the threat of strikes or actual ones; a hedge against a dock tie-up; the growing demand of an affluent society willing to spend a rising share of its income on imports (now 3.8 per cent of the GNP against a customary rate of 3.0-3.3 per cent). Also a desirable readjustment in our trade balance with Canada should be mentioned though it added to the decline in the trade surplus.

What of 1969? Export gains in aircraft, automotive products and chemicals are expected to continue. Economic expansion in Europe, in particular Germany, will favor US exports, and the British market, too, will become more attractive for capital goods. US products also should find expanding markets in Canada and Japan. While total US exports thus may increase by 10 per cent or better, the bigger change in 1969 may occur on the side of imports not advancing over the high 1968 level. This slowing-down process may result from less consumer demand and declining industrial needs in view of excessive inventories and less inflationary pressures. A recovery in the merchandise surplus may also come because of a slowing-down of the Viet Nam war, specific measures to aid exports and certain restraints on imports to enforce non-discrimination.

### **The Burst of Capital Inflows**

In the over-all balance of payments, capital exports responded to the tightened controls and were cut in half to \$2 billion while the ceiling on foreign lending by US banks was maintained. In a recent report, the old President's Cabinet Committee on the Balance of Payments called for a continuation of all existing restraints for 1969 including the interest-equalization tax. It also called for restrictive fiscal policies aiming

at a budget surplus and a continuation of the surtax until disinflation will "restore our competitive position and return a healthy trade surplus". While capital export restraints were sharply criticized by President-elect Nixon during his campaign, the Secretary of Commerce Stans recently declared that he needs "more facts" before recommending their removal. Hence, only an end to the war and/or "durable balance of payments surpluses" and the assurance of a "long-term equilibrium" are expected to lead to a relaxation of present controls.

The great surprise in the balance of payments, that prevented the growth of the deficit to 5 or 6 billion in 1968, was the burst of capital inflows consisting of purchases of US stocks and bonds, repayment of loans to US banks and borrowing by US foreign subsidiaries in favor of their US parent banks. In the actual deficit of \$1.6 billion, the direct costs of the Viet Nam war should be set at \$1.5 billion but according to Repr. Henry Reuss an equal amount was added by the costs of inflation, diversion of foreign trade and smaller exports all related to the war. (In other words, without the war, there would have been a surplus of \$1.5-2 billion).

In the outlook for the 1969 balance of payments, a careful weighing of the various factors—the slowing-down of the war, the continued political uncertainty in Europe, the fight against inflation, the balanced federal budget, the greater efforts towards exports and a certain saturation with imports—permit the projection of a liquidity deficit of \$1 billion. Likewise, we should expect an improvement in the structure of the balance based on less uncertainties and sharp swings in the movement of merchandise and capital.

### **The Case of Germany**

While world trade, now exceeding \$400 billion, rose by 8 per cent in 1968, Germany as well as Japan and Italy experienced faster growth rates. The growth in the German National Product at a rate of 7 per cent or better proved once more to be inextricably related to the export boom. German exports advanced by more than 12 per cent and achieved a significant surplus of \$4 billion on the merchandise balance. Trade with the US contributed substantially to this favorable picture, with German exports having zoomed by 40 per cent in 1968 alone! In view of the prompt neutralization of such surpluses but also of US defense spending in Germany through the German purchase of US Treasury bonds, military equipment and US stocks and bonds, the United States views this relationship as beneficial.

In the recent financial crisis, due to several misinterpretations, it appeared as if US official quarters were approving the French and British demand for an up-valuation of the Mark. Noth-

ing is further from the truth: the long-standing experience of the US indicated that the huge surpluses on the merchandise balance did as little indicate an "under-valuation" of the dollar as their disappearance would not prove an "over-valuation" of the dollar. The US government rejects the view that in such crises it becomes the duty of the creditor to carry the main burden of the necessary adjustment<sup>1</sup>. When the US was running large balance of payments surpluses, no plans were devised to reduce them deliberately but these periods coincided with rising foreign aid and private capital exports which, in turn, restored a new balance (which would have prevailed without the Viet Nam burden). Furthermore, the over-all German balance of payments, in historic perspective, is not inevitably surplus-producing and, hence, the accumulation of surpluses is needed to maintain stability in less prosperous periods.

The Nixon Administration shares the German view of modern monetary and fiscal policies in the fight against inflation and German attitudes with regard to budget deficits, the avoidance of depreciation or up-valuations and the preference of as many market freedoms as possible in the international as well as the domestic economic sector.

In the year ahead, the US expects to increase its share in the German import market above the present 12 per cent rate. Naturally, German imports by the US will also grow but not at the explosive rate of last year. It is expected that US financial and economic markets will remain attractive for additional capital inflows. Concerning the Common Market, a further deterioration of the US balance has disappeared while the service balance and that of NATO spending are widening the gap. Prohibitions of capital exports by France and perhaps some of the other members except Germany will prevent a re-balancing of this deficit.

### **Areas of Friction**

The United States continues to favor the expansion of foreign trade in goods, services and capital flows. As pointed out, obstacles to the freedom of US capital movements will be dismantled to the extent that the elimination of the deficit in the balance of payments will permit it. Exports will be encouraged and are expected to enter foreign markets easier because of the recent tariff cuts according to the Kennedy Round<sup>2</sup>. Nevertheless, non-tariff obstacles to US

<sup>1</sup> For this reason, the US government was not pressing for the sacrifices of the 4 per cent tax imposed on exports and equivalent benefits for imports instituted by Germany. In fact, this mechanism to reduce "excess merchandise surpluses" is little commented upon if even appreciated.

<sup>2</sup> The US reduced tariffs by another fifth on schedule as the second instalment of the Kennedy Round on January 1, 1969, and is now equal in cuts made by the Common Market last July. A deferment of this cut, though offered, was not accepted because the condition for it, namely to repeal the American Selling Price System for Chemicals, was not legalized.

imports have generated perhaps the most determined protectionist climate and retaliatory atmosphere since the enactment of the Smoot-Hawley Tariff Act of 1930. This does not mean that the New Administration blindly proposes to undo all international trade freedoms so laboriously constructed in recent years. In fact, the Foreign Trade Convention continued to oppose all protectionist devices including "orderly marketing quotas" and asked only for fighting unfair foreign competition within existing US laws and provisions provided by GATT. Nevertheless, to the extent that US exports meet obstacles on part of the prosperous European countries, counter-measures will be more likely taken than in the past. Particular irritants are the Common Market levies on US agricultural exports, the flooding of the US steel market, imports now furnishing close to 20 per cent of total domestic consumption and the operation of border taxes nullifying the expected benefits from lower tariffs. While all these problems are intricate, legal and frequently related to domestic tax patterns, the over-all outlook is quite clear: the US will strike back in every possible way to achieve the removal of trade-impeding practices abroad even though such steps might lead to a deterioration of the entire climate of foreign trade not excluding quotas and other limitations on imports.

#### **No New Bretton Woods**

Other sources of disturbances would be new obstacles to the early introduction of Special Drawing Rights. This measure, long over-due, must not be delayed much longer because of narrow nationalism. Obviously, this measure, favoring the world community and in particular developing nations, will not solve the US deficit but it should promptly be taken as token of international monetary cooperation. Little can be gained, too, by nations putting pressures on the US to force acceptance of an increase in the price of gold. The present Central Banks' holding agreement concerning gold remains the necessary basis of international financial harmony.

The recurrence of hot money flows—recently into Germany but also to the US and earlier last year from the US—has not yet attracted sufficient corrective actions. The outgoing Secretary Fowler suggested the "re-cycling" of such flows to the countries from where they came, though ways have to be found to distinguish between legitimate capital exports and speculative flight money. Certainly, the recent move of French francs and other currencies into Germany was merely speculative in the expectation of forcing up the price of the mark to achieve a modest but riskless up-valuation gain. Changes in payments patterns in merchandise trade and shifts of funds by international corporations, too, can precipitate leads and lags adverse to the stability of currencies.

A sudden withdrawal of private or Central Banks' funds from the major debtors England and the US could cause financial panics.

While no easy solution to these problems is at hand, immediate, specific, short-run crises must more effectively be dealt with by the Monetary Fund. No new organization or new Bretton Woods is needed but action within existing facilities. Still greater cooperation of Central Bankers, in addition to lending operations by the Ten, swaps and special ad hoc arrangements, is imperative to safeguard international credit, currencies and liquidity. Long-run improvements, obviously, must go to the roots of these disturbances: the fighting of domestic inflation by effective fiscal and monetary means; the balancing of flows of merchandise, services and capital within the means of a nation; and the minimization of political crises if they are of a domestic nature. International political threats that are bound to spill over into international finance can only be met successfully by closest cooperation of the entire Free World.

#### **Various Other International Prospects**

Foreign aid as seen by the business community is crucial in the inter-action between prosperity of the industrially advanced countries and the developing nations. The new President of the World Bank, McNamara, commands respect and will bring top management and greater activities to the Bank. Concerning the actual amount of foreign assistance to be given by the US, the outlook is not promising and the frequently called-for 1 per cent of the National Income to be allocated to this purpose remains unattainable. While US grants and loans exceeded \$4 billion in 1967, such appropriations for the fiscal year 1969 (to be administered by the Agency for International Development: AID) were cut to \$1.37 billion. Naturally, some funds previously appropriated but not yet spent will increase this total but no spectacular gains should be expected even in case of an early termination of the war. Future emphasis will be on the own efforts of the developing nations, in particular by encouraging free private enterprise and investment. Mutually self-supporting action between private and public investment must serve both industrial and infra-structural development. In this process, the host country must develop a true investment climate to permit private enterprise to operate more freely. Of equal importance, however, is the development of a new realism by capital exporting countries in their attitudes toward the national needs, goals and customs of the receiving countries.

The New Administration is thinking along these lines and will present to Congress by July 1, 1969, proposals of a federally chartered private cor-

poration to mobilize US private capital and skills for use in developing areas. As further aid to such nations, the granting of non-discriminatory tariff preferences is not being opposed by business leaders. The New Delhi proposals are acceptable provided that they are but temporary and will be extended jointly by the advanced nations and reciprocated by the elimination of discriminatory practices to achieve faster progress in trade liberalization.

### **The English Pound and the French Franc**

While the devaluation of the pound in 1967 did not yet remove the deficit in the balance of payments, a general further improvement of the English situation is expected. The \$5 billion line of credit is increasingly making its impact felt while coordinated strong fiscal and monetary measures of restraint slowly but inevitably force the British economy to live within its means. The faster expansion in British key exports is expected to continue into 1969 and further controls will prevent domestic inflation from disturbing once more the balance of payments. Recent history has disproved the assumption of an inextricable link between the pound and the dollar, the latter, hence, having become less vulnerable to swings in the former.

The French franc faced with a confidence crisis as result of a peculiar form of capital flight (namely aiming at a revaluation profit from the mark), indicated no intrinsic balance of payments weakness. France is expected to remain competitive in world markets by additional tax relief, export subsidies and anti-inflationary measures favoring exports. Ultimately, much of its flight capital will return because of greater political stability and new attractions to repatriate funds, combined with more effective sanctions against flight capital operators.

In view of the dependence of the entire monetary system of the Free World on a reasonable stability of the pound, franc and also mark, all industrial and financial powers in the world are bound to cooperate—in their very own selfish interest—assisting each other to prevent crises. Obviously, internal economic, fiscal and monetary policies are greatly responsible for such prevention but at times external events beyond the control of any one nation, may require fast concerted action first, and internal adjustment later.

### **The Future**

The US is looking forward to a continued growth of world trade by another 8 per cent in 1969 and expects to make its contribution to greater international stability and progress by better control of domestic inflation and the dismantling of

most obstacles to freer trade and credit. Not only will the federal budget finally achieve a surplus but greater internal discipline is expected that will make possible to reduce the deficit in the balance of payments to an acceptable \$1 billion.

In the overall approach to international economic policies, the US wishes to remain liberal and to continue the spirit of GATT and the Kennedy Round. No experimentation with traditional international standards will be tolerated: the operation of the gold exchange standard at fixed exchange rates remains the best possible system. The position of gold, too, in the system of Central Banks at home and abroad as well as its price at \$35,— per ounce, are not to be changed. US monetary policies will do everything to enable other countries to maintain their currencies unimpaired: to support the French franc or any other major currency against devaluation and the mark against pressures to up-value. Without the need of "reforms" of the Monetary Fund, action will be encouraged to complete the Special Drawing Rights arrangements and to strengthen still further the existing support system for weak currencies or those under attack. Stand-by swaps and other lending facilities will be increased, too. There is no reason why a strong armor against any new financial disturbances of whatever causes or nature cannot be assembled by March.

The various grievances of the US, dealing with non-tariff border taxes, excessive steel and textile imports and insufficient sharing in the common defense expenditures abroad, will come to a head though Europe has its complaints, too, such as the "Buy American Act" and our excessive balance of payments deficits. These are complaints, however, that can be most amicably settled and Germany already has made a significant contribution—in fact and in principle—by measures taken to reduce its large surplus on the merchandise balance.

Former Representative Thomas Curtis should be expected to mastermind the measures needed to improve the US balance of payments but much will depend on effective fiscal and monetary policies in their new objectives to reduce the rate of inflation from 4 per cent to 2 per cent annually. Naturally, a decline in Viet Nam spending abroad will be of great assistance in the restoration of this balance. Finally, the continued development of the multinational firm—with the parent established in whatever country—is considered vital for the betterment of living standards everywhere. In this respect, Europe itself must repudiate the narrow, nationalist thesis of Servan-Schreiber, if it does not want to advance Communist objectives ultimately. In conclusion, an expansion of foreign trade, services, capital flows and international credit, under more stable conditions than in 1968, should be expected.