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Economic Outlook for 1970

by Professor Robert G. Wertheimer, Cambridge/Mass.

In view of the continued leadership of the dollar as source of international reserves, financing and capital flows, the strength of this currency remains a vital factor in international stability. Hence, the importance of the US balance of payments. 1969 was a disappointing year in the restoration of the traditional surplus on current account needed to finance the deficits on private capital exports and public accounts. Even so, with a surplus of \$1.3 bn on this balance, it will be better than 1968 but will fall short of the usual surplus of \$4-5 bn. Latest merchandise figures for 1969 indicate gains in exports by 4 p.c. to \$36 bn—a disappointing result in view of the surge of Free World exports by 13 p.c.¹

The US Balance of Payments

Dwindling trade surpluses already are forcing the American business community to generate greater efforts to expand exports. The boom in the US domestic market, continued inflation at least at a rate of 5 p.c. and other factors nullified all efforts so far undertaken to expand exports more rapidly. Regardless of this situation, and in particular of the fact that imports continued to rise and reached \$35 bn (plus 6.7 p.c. over 1968), the freer trade concept of previous Administrations will be continued.

In terms of the overall balance of payments, 1969 showed two sides. While a large surplus of \$2 bn was recorded on the official balance, the liquidity balance was in a steep, not-to-be-repeated deficit of \$6.8 bn.

The US international reserve position, responding more to movements on the official than liquidity balance, remained stable with total reserve assets amounting to \$16 bn at the end of 1969. Whatever the balance development in 1970, the liquidity deficit should be expected to be reduced sharply to \$2 bn by a combination of several factors: a continued net increase in the surplus on current accounts and a reduction in public spending abroad though net private

capital flows are expected to remain unchanged. The surplus on the official balance might decline to \$1 bn permitting a better balanced overall position of the US. In any case, the willingness of foreigners to hold dollars increased in 1969 making for a strong currency, a situation which is expected to be continued in 1970.

Exports and Imports

Concerning commodity trade in 1970, exports in construction-, mining- and agricultural machinery and machine tools are expected to gain; major growth items will be chemicals, communications, electronics equipment and aerospace. In spite of world hunger and great US efficiency in the production of food and of other agricultural products, narrow nationalism and various control schemes continue to reduce this category of US exports down now to about one-fifth of the total. In balance, it should be expected that exports will grow better than in 1969, close to 10 p.c.² If the much advertised slow-down of the US economy, at least in real terms, should occur, imports into the US will not expand by more than 4-5 p.c. In fact, a standstill might take place, bringing effective though undesirable relief in restoring major surpluses on current account. In the same direction, a decline in tourist spending due to a slower economy could save \$500 mn. Altogether, it should be expected that the US merchandise balance will improve by at least \$1 bn. On the private capital balance, much will depend on the need of Euro-dollars, their competitive earnings in Europe, and other short-term lending. While the outflow of US funds for direct investments will moderately expand to \$3.5 bn, larger return transfers of US investment earnings abroad also should be expected. A decisive factor in reducing the liquidity gap to approximately \$2 bn will be a cutting down of federal spending abroad. Here, unexpected but major reductions may come about faster than presently expected³.

¹ In 1969, world exports climbed to \$270 bn with biggest gains shown by Germany (plus 14 p.c.), Japan, followed by the US, France and the United Kingdom. Of this total, developed nations once more were responsible for an increasing share of \$193 bn. The increase in Common Market imports by 25 p.c. over 1968 added significantly to the overall growth of world trade.

² The competitive position of US unit-export prices is not unfavorable; they advanced by 3 p.c. in 1969 or at the same rate as European prices. For 1970, some improvement is expected.

³ Not only a more rapid fading out of Viet Nam fighting might help but also a sharp reduction of other forms of international spending, not only less foreign aid but a drastic reduction in the on-shore spending for the defense establishment affecting largely NATO and Japan.

In the near future, the US-Government wishes to put every effort into export expansion. The Cabinet Committee on Export Expansion has set an export target of \$50 bn annually by 1973 (at 1969 prices). This will mean an increase in exports by 40 p.c. from the current level of \$36 bn. The Administration is standing firmly behind the principles of Gatt, non-protectionism and elimination of non-tariff barriers. Increasing emphasis is put on the securing of competitive export financing not only by more action of the Export-Import Bank but also tax advantages⁴ and the elimination of all obstacles in the path to freer trading. Through private and public channels, the US will also continue to furnish investment capital to developing nations which much depend on such assistance and technology for further progress.

President Nixon asked in his Trade Bill of 1969 for authority to reduce certain tariffs by 20 p.c., to eliminate the American Selling Price System (SPS) of customs valuation, to abolish non-tariff barriers by negotiations in line with the GATT plans proposed for the meeting in February and to liberalize existing provisions for granting relief to industries, firms and groups of workers injured by imports. At the same time, the bill proposes broader retaliatory powers to be given to the President, to deal with "unjustifiable" restrictions on US exports. Such legislation with "teeth" is being proposed as a flexible substitute for the far stronger demands for import quota legislation on part of protectionists pressurizing Congress.

Foreign Investment Trends

In full recognition of capital needs abroad, present curbs on capital exports for direct investment are being relaxed, particularly to assist medium-sized US companies. In 1970, about \$3.5 bn of such capital will move abroad (against \$3 bn in 1969). Total US subsidiary investment abroad, however, will amount to \$11 bn utilizing for financing also internal cash-flows, local borrowing and the sale of stocks of the parent companies. In addition to the use of Euro-dollars as means of short-term financing, American corporations and their subsidiaries also borrow in the international bond market, though in smaller amounts.

While the export of capital for investment turns up as immediate equally-sized deficit in the balance of payments, it has become the principal source of long-term assets owned by US companies abroad. The total of US assets abroad

(of any kind) rose by \$12.5 bn in 1968 while corresponding US liabilities increased by only \$11.4 bn. At the same time, earnings on foreign direct investments which annually are being transferred to the US, play an increasing role as surplus producer on the US balance of payments-current accounts.

Reduced Danger of Monetary Crisis

The ingenuity of American and foreign banks is creating effective international monetary links of unheard dimensions. Savings and other financial resources are now put to instant profitable use anywhere. The universality of the dollar, but also the strength of all other major currencies, is further supported by official currency swap systems and the vast lending powers of the Monetary Fund and of its wealthy members. Monetary authorities now cooperate more than at any time in their history in maintaining the stability of the dollar and of all other currencies needed in world trade. The amazing growth of the Euro-dollar market continues to provide abundant flows of short-term financing at profitable interest rates of 10 p.c. and better⁵.

1969 saw the gradual minimization of the spectre of a monetary crisis and several measures were taken to reduce if not eliminate major imbalances of payments and hence financial disequilibria. The earlier devaluation of the pound sterling begins to pay off now. Britain not only is earning a surplus on the balance of payments but also can afford to eliminate most burdensome currency restrictions such as those on foreign travel. The more recent devaluation of the French franc was carried out successfully with surprising secrecy and dispatch. The French balance of payments situation is improving, too, and capital flight has been sharply reduced. The upvaluation of the D-mark further benefiting the French competitive position has begun to reduce European trade and payments imbalances. While the speculative and disruptive powers of gold as monetary metal were firmly controlled in 1969, no "outlawing" of this ultimate means of settlement in international payments, or at the level of the Monetary Fund, was ever contemplated. The fad of flexible exchange rates or even of the "crawling peg" as solution to international imbalances has been rejected reflecting sound financial and business judgement. A wider support range of currencies at 1-2 p.c. around official parity, on the other hand, might become a promising tool of further adjustment of exchange rates toward more stable balance of payments equilibria.

⁴ An adoption of a "value-added" tax is out of the question due to Congressional opposition.

⁵ The total Euro-dollar market exceeds 30 bn of which one-half was borrowed by US parent banks (8 bn alone in 1969).

Future of the Dollar

What of the future of the dollar? In view of the increasing enforcement of anti-inflationary measures (though a time lag until they achieve more visible results must be allowed for), the achieving of a surplus in the federal budget or at least the avoidance of deficits, and of various other measures under way to bring about a permanent reduction in the US balance of payments deficit, it is inconceivable that the dollar parity could be forced to change. On the contrary, the stability of the dollar was strengthened further by the successful upvaluation of the D-mark, the steadily improving position of the pound and the greater cooperative spirit of the French monetary authorities. However, the dollar being the international and reserve currency and widely used credit tool (80 p.c. of Euro-currencies are in dollars) has the ever increasing obligation to live up to its role as stable and fully convertible asset and no complacency can be tolerated in this matter. The issuance of Special Drawing Rights as International Reserve Assets to the amount of \$3.5 bn equivalent in 1970 is not being provided to finance deficits but to increase international liquidity, exchange stability and foreign trade⁶. The IMF is also increasing the quotas of members by \$8.6 bn to a total of \$28.9 bn in order to strengthen the world monetary system and the quality of all currencies of the member nations. At the same time, the power of gold to disrupt the international monetary mechanism has now been reduced.

Trade with Germany and the Common Market

The trade between the US and Germany is entering a very prosperous phase. On the average, the US purchases 8 p.c. of total imports from Germany and the latter provides an outlet for 7 p.c. of total US exports. In 1969, the value of total US-German merchandise trade climbed to \$5.5 bn balanced half-half between them⁷. The year did not continue the explosive expansion of German exports to the US similar to 1968 when gains amounted to 40 p.c. but the reliance on German products by industry and the consumer is ever increasing. One out of every three cars exported by Germany went to the US and one-seventh of all machine exports⁸. Booming

conditions in Germany and rising imports in 1969 (by 21 p.c. over 1968) also created an attractive market for US exporters. The upvaluation of the D-mark will enhance the US competitive position and reduce according to a German survey recently undertaken the "greatest hurdle" against an expansion of US exports to Germany, namely "high US prices". At the same time, it is unlikely that German exports, at least to the US, will suffer hardship from the upvaluation in view of the acceptance and preference for such products. Imports remain a major and attractive anti-inflationary weapon in the US and only an economic slow-down beyond expectations could reduce import levels in 1970 below those of 1969. In this case, US exports to European countries, in particular to Germany, should be expected to boom more rapidly in search of solvent markets, US goods also becoming available for more rapid delivery than in the past. While Rotterdam has become the US distribution center for the entire Common Market, the projected development of the Port of Hamburg indicates great opportunities for Germany as key shipping partner in that area.

Concerning the Common Market as a whole, the US carries on large and profitable trade also with the other members of this group. In a recent talk before the American Chamber of Commerce of Paris, Mr Davis, Assistant Secretary of Commerce, called for a new dedication by governments and industry of the US and the members of the Common Market to improve the framework of their world business. While the President wishes to eliminate the American Selling Price System as his special contribution to freer trade, the Common Market Agricultural Policy (CAP) is considered as a damaging expansion of new protectionism. Two of the most ardent free trade advocates, Senators Javits and Percy, even caution on the negative effects of the projected entry by the United Kingdom into the EEC particularly through the extension of the protectionist CAP devices. Europe little understands that agricultural exports remain of greatest economic and political significance to the US.

Preferences and Foreign Trade

President Nixon recommended on November 10, 1969, the granting of special tariff preferences to less developed nations. In essence, such measures would eliminate import duties by all "rich nations" on all manufactures and semi-manufactured exports of nations covered by this arrangement for about one decade. This encouragement of manufactured exports from developing countries has several objectives: to assist them in expanding production to create jobs;

⁶ The US share in SDR will amount to \$867 mn in 1970. These drawing rights together with the increase in the resources of the Fund will advance total world liquidity from \$74 bn presently to \$66.7 bn (10.5 bn in SDR over three years and a 2.2 bn increase in the reserve positions of members).

⁷ In 1968, the \$5 bn trade total was composed of \$2.75 bn US imports from Germany (with a gain of 750 mn over 1967) and \$2.25 bn worth of US exports to Germany (with only a small gain).

⁸ In 1969, German car exports to the US were amazingly well maintained at almost two-thirds of total US car imports in spite of rising competition. Moreover, foreign-made cars increased their share to 11.4 p.c. of total new car sales in the US.

they also must increase international exchange earnings to finance rising imports and to continue service on their debts—already requiring several billion annually for service and repayment. Implicit in this encouragement of their domestic production is also the realization by the mature nations that they increasingly will depend on the economic strength and stability of the developing nations which happen to be the major suppliers of needed raw materials.

The Foreign Aid Bill 1970, originally proposed by the President for a total of \$ 2.6 bn, was reduced to \$ 1.3 bn for Economic Aid to developing countries and \$ 300 mn in military assistance grants chiefly to Southeast Asia. Victim of the generally tight budget, this kind of assistance has been reduced to a minimum now also reflecting the general American tiredness with any outside involvement so long as the extrication from Viet Nam is not around the corner. Only until major US problems such as the war, inflation and domestic needs of greatest priorities will have been reasonably solved, will the foreign aid sector, at least where the flow of public funds is concerned, become revived. In spite of great urgency for such aids particularly for Latin America, this retrenchment is deep-seated and more generally approved by the public than is assumed at home or abroad. As a substitute for cash aid, at least freer trade for developing nations which depend greatly on the markets of the rich nations, is considered vital⁹.

The East-West Trade

The Nixon Administration remains reluctant to act quickly in the removal of obstacles to this trade in spite of improving political relations with the Soviet Union and friendly overtures to some of the Satellites. Legally, the path for greater trading with Soviet-controlled areas was cleared by Congressional approval of compromise legislation on export controls. The Export-Control Act of Dec. 24, 1969, gives the Administration the flexibility to increase Soviet trade, in particular by the authorization to grant export licenses for products that are available to Eastern countries elsewhere in the West (the Common Market and Efta).

On the basis of this reluctance to push Eastern trade in spite of encouragement by the Congress and growing pressures on part of the business community, no significant increases in US exports to Communist countries should be expected.

⁹ Developing nations ship 75 p.c. of their total exports to the developed nations, but even so they share with only one-fifth in total world trade.

In 1968, this total amounted to \$ 200 mn with one-third of it being shipped to the Soviet Union. Apparently, the Administration wishes to accomplish first a general improvement of Soviet-US relations (political, in the Near-East, in disarmament talks) to be followed later by an enlargement of trade, a procedure which the Russians call "putting the cart before the horse".

In trading with China, a more political than economic motive is underlying the new permission given to US foreign subsidiaries to buy and sell Chinese-made goods or raw materials and to „finance, ship, or insure“ such items. While these affiliates cannot re-export such goods to the US, they can incorporate them into new products sold to the US¹⁰.

The Outlook

1970 again will be an expansionist year in world trade with some slowing-down, but not necessarily for the United States. There are domestic priorities such as fighting inflation and the protracted impact of previous monetary and credit excesses and distortions calling for prompt adjustment. In particular, the excessive US deficit on the liquidity basis in 1969, excessive utilization of Euro-dollars by US parent banks, the changes in parities of major currencies, all need to be digested and reappraised. For the US, in particular, the slower pace of economic growth, projecting a real growth rate of only 1 p.c., should have a sobering effect.

On this basis, the US is expected to gain more in the growth of exports (by 10 p.c.) than imports (by 4 p.c.) though the total may average out at 7 p.c. The balance of payments deficit on the liquidity balance is expected to be reduced sharply to \$ 2 bn with a smaller surplus of 1 bn on the official account thus bringing the overall balance into a far better equilibrium than in the previous year. Concerning merchandise flows, better financing techniques will assist in the expansion of exports while the import boom might have spent itself for the time being. The international spirit of the Administration remains liberal favoring the reduction and ultimate elimination of all barriers to trade as logical extension of the once so promising Kennedy Round concept, and opposes protectionism as such. Restrictions on foreign direct investment are being gradually reduced to enable private enterprise to make its full contribution to economic progress abroad.

¹⁰ In other words, regulations prohibiting direct trade between the US and the Chinese People's Republic, based on the 1917 Trading with the Enemy Act and its many amendments, remain intact. Bona fide tourists can now freely purchase and import Chinese goods.