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Volume Title: Problems of the United States as World Trader and Banker

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Volume Publisher: NBER

Volume ISBN: 0-870-14153-8

Volume URL: <http://www.nber.org/books/lary63-1>

Publication Date: 1963

Chapter Title: Elements of Strength and Weakness in Basic Transactions

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Chapter URL: <http://www.nber.org/chapters/c1911>

Chapter pages in book: (p. 44 - 98)

Chapter III

Elements of Strength and Weakness in Basic Transactions

1. *The Risk of Overexplaining the Balance of Payments*

The belief in a chronic dollar shortage continued to be widely held until long after the United States balance of payments had shifted, at the beginning of the 1950's, to a deficit. The persistence of this view is not so strange as may sometimes appear. The new deficits were not ignored, but they seemed to repose on uncertain foundations: United States military forces and expenditures abroad, which reached high levels during the Korean war, might again recede as rapidly as they had after World War II; economic aid to Europe had been completed and aid to the less developed countries had not yet been widely accepted as a regular, if not also growing, obligation; the receptivity of the United States to increased foreign competition in its own market remained subject to test; many countries in Europe and elsewhere still thought it necessary to impose quantitative restrictions against imports from the United States.

Under these circumstances, a judgment at that time that the dollar shortage had ended was not, as may now appear, a conclusion emerging unequivocally from the currently reported balance-of-payments figures, but involved an assessment and forecast of the underlying

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causal forces at work, political as well as economic.¹ It is not surprising that attitudes and expectations differed. The very increases which some countries were able to achieve in their reserves as a counterpart to the United States payments deficits during the pre-Suez period could be taken as evidence of their continuing hunger for dollars.

What is strange is not so much the general failure to recognize earlier that the dollar shortage had ended. It is rather the strength of the widely held view that it might never end, that it reflected some kind of enduring structural advantage on the part of the United States, and that corrective adjustments would be difficult or impossible to achieve.² Among the elements deemed to account for the superiority of the United States and the strength of its international payments

¹ For example, it was common practice in the mid-fifties to treat United States military expenditures abroad as "extraordinary." Thus, the seventh Annual Report of the OEEC showed, for the member countries combined, during 1954-55 a surplus of \$1.4 billion, including military receipts from North America, but a deficit of \$600 million if these receipts were excluded. The report further noted that military receipts from the United States were expected to decline by \$400 or \$500 million in 1956-57 and again in 1957-58, and expressed concern over the long-run outlook for Western Europe's balance of payments because of "the heavy reliance on United States extraordinary expenditures, the failure of exports, particularly dollar exports, to expand with the same rapidity as imports and the difficulties of increasing gold and dollar earnings from third areas" (*Economic Expansion and its Problems*, Paris, February 1956, pp. 51-63). As it turned out, the evolution of U.S. military expenditures abroad was the opposite of that anticipated by the OEEC. From 1954 to 1958 (calendar years) these expenditures rose by \$400 million in Western Europe and by an additional \$400 million in other areas. In view of the problems presented by German balance-of-payments surpluses, culminating in the upward revaluation of the mark in March 1961, it is ironical to observe that the rise in U.S. military expenditures in Western Europe was entirely attributable to the assumption by the United States of payments for local supplies and services previously furnished by the West German Government. A similar shift in Japan contributed, though in much smaller measure, to the increase noted above in U.S. military expenditures in non-European areas.

² Much earlier, in a paper presented shortly after the end of the war, I disagreed with the idea already current of a "chronic" shortage of dollars. While observing that "the position of the United States at the moment seems to be one of unchallenged strength," and that "this lack of balance will be intensified during the next few years until foreign productive capacities are restored," I expressed the view that "it would be foolish to assume that these advantages will remain so unique as they are today," and that "the relationship may be profoundly altered during the next several decades" ("The Domestic Effects of Foreign Investment," *American Economic Review*, May 1946, p. 681).

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position were:³ the high productivity of its mass-production industries; the intensely competitive atmosphere of the United States; its technological and innovational leadership, reposing on large investments in plant and research; the favorable product structure of United States exports of manufactures; the favorable geographic distribution of its exports, with more than half (as against one-tenth for Western Europe) going to the "rapidly growing countries" of the Western Hemisphere; its relative self-sufficiency; United States tariffs on imports of manufactures and its low price elasticity of demand for primary products; its low propensity to invest abroad compared with the strength of its foreign trade position; the supposedly better resistance of the United States to inflationary forces than that shown by other countries; the unlikelihood that American economic aid to other countries would increase enough to fill the gap; the unwillingness of governments to contemplate devaluations on such a scale as would be necessary and the probability that, in any event, the balance would again be disturbed by inflationary tendencies released in the devaluing countries or by the continuation of other adverse trends, and perhaps also by the flight of capital to the United States.

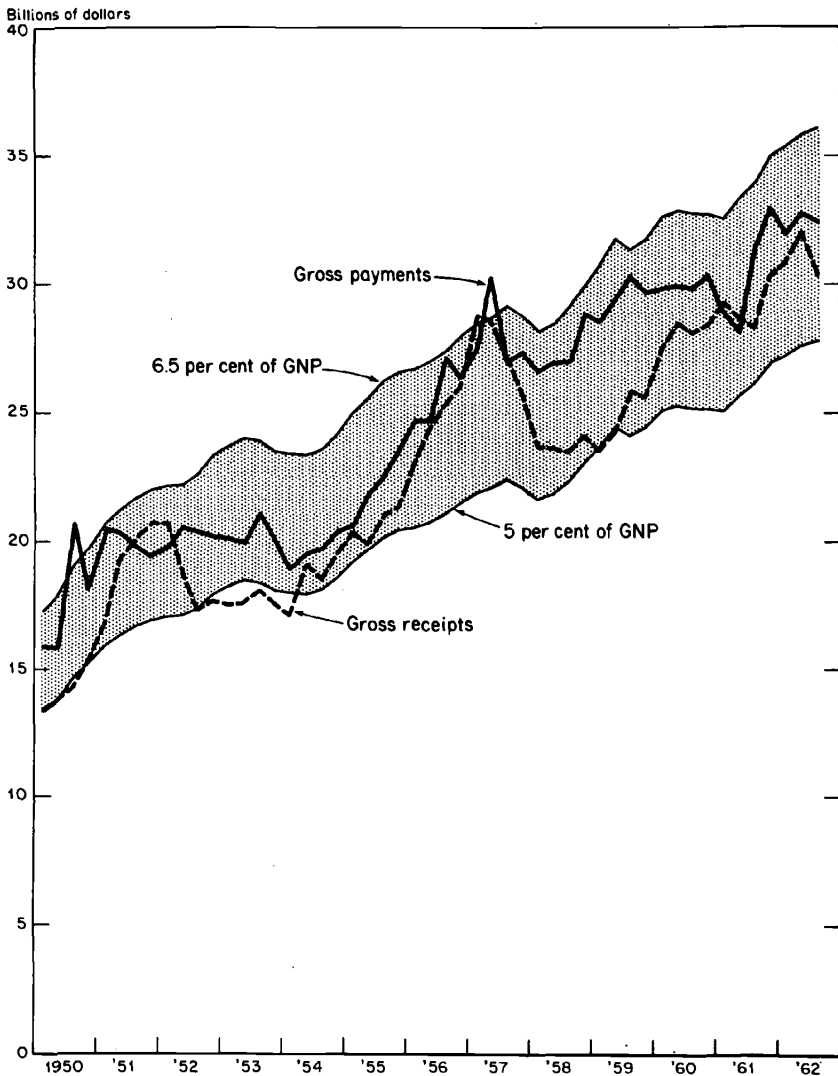
With the pronounced shift in the balance of payments for the worse after 1957, a variety of new explanations have been adduced, some of them the reverse of the propositions previously advanced to explain the dollar shortage. This is not to say that these new explanations do not have great persuasive force and relevance. They do indeed appropriately stress certain basic changes in the world economy which have profoundly affected the international position of the United States; these changes will be examined below in Section 3. One may, however, wonder if there is not again a risk of overexplaining the disequilibrium and of neglecting forces working in the opposite direction; these will also be considered.

³ The list given is a composite of explanations from various sources. Probably the most uncompromising statement along these lines, though not including all of the elements mentioned, was given as late as April 1957 by Sir Geoffrey Crowther, who referred to his idea conceived twenty years earlier of a "permanent and organic shortage of dollars" and considered that the United States occupied "a position of relative strength without any parallel in economic history" (*Balances and Imbalances of Payments*, Cambridge, Mass., 1957, pp. 34, 45). Sir Donald MacDougall in his major work published about the same time explored the subject in far more detail and with many qualifications but considered that "structural changes" were likely to produce a progressive deterioration in the payments relations of other countries with the United States and saw little hope of a satisfactory solution (*The World Dollar Problem: A Study in International Economics*, London, 1957).

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CHART 8

**U.S. Payments and Receipts on Basic Transactions
in Relation to Gross National Product
(seasonally adjusted, annual rates)**



NOTE: Receipts exclude unscheduled debt repayments to U.S. Government.

SOURCE: U.S. Department of Commerce (see also Appendix Tables B-1 and B-2).

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The need for caution in developing explanations of balance-of-payments behavior is suggested by the data presented in Chart 8, which shows the gross flows of international receipts and payments of the United States on basic transactions. These flows, though fluctuating enough to produce wide movements in the balance, have adhered to a fairly narrow path in relation to the gross national product. Since 1950, the totals for both gross receipts and gross payments have generally remained within the range of 5 to 6.5 per cent of GNP, payments usually being in the upper part of this band and receipts more often in the lower part.

These comparisons are one way of saying that total foreign transactions and variations in them are small in relation to total American economic activity. They also serve as a reminder that relatively small shifts in the rate at which American incomes are earned or spent abroad may have disturbingly large effects on the balance of payments. The margin to be explained, however crucial in relation to monetary reserves and to the functioning of the economic system, is a fairly narrow one in relation to the sum of economic forces at work.⁴

2. Increase in Balance-of-Payments Burdens

The first thing to be noted, before consideration of the more intensive competition facing United States foreign trade, is that the operations to be covered out of the surplus on goods and nonmilitary services have greatly increased during the past decade. It was observed in Chapter I that these operations, net of corresponding receipts, now add up to some \$8.5 billion annually. As may be seen in Table 7, this represents an increase of \$3 billion over the annual averages during the early 1950's.

By some relevant standards these burdens are not large. They amounted to only 1.7 per cent of gross national product in 1960-1961, and the increase since 1953-1955 is only 2.2 per cent of the increase in gross national product during the same time. They have nevertheless

⁴ As Sir Donald MacDougall has said in his reappraisal of the dollar problem: "There is a strong human tendency to assume that the balance of payments cannot change very much from what it is at the moment. This may be due to natural conservatism or perhaps to lack of imagination. In fact it can change very rapidly. The fundamental reason is, I suppose, that it is a marginal part of a marginal part. The balance is a marginal part of the total trade and the trade is in turn a marginal part of the national income" (*The Dollar Problem: A Reappraisal*, Princeton, 1960, p. 64).

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TABLE 7

**GOVERNMENT TRANSACTIONS^a, PRIVATE INVESTMENT, AND
REMITTANCES AND PENSIONS, BY SELECTED PERIODS, 1950 TO 1962**
(millions of dollars, annual averages or annual rates)

	1950- 1955	1953- 1955	1960- 1961	1962, Jan.- Sept. ^b
<i>Payments</i>				
U.S. Government grants and capital	2,912	2,410	3,728	4,303
U.S. military expenditures abroad	2,010	2,719	2,998	2,971
U.S. private long-term investment abroad:				
Direct investment	701	742	1,584	1,239
Portfolio investment	254	125	928	1,092
Remittances and pensions	557	606	860	904
Total	6,433	6,602	10,098	10,509
<i>Receipts</i>				
Repayments on U.S. government loans	406	470	611 ^c	599 ^c
Receipts by U.S. government on military transactions	192 ^d	191	370	916 ^e
Foreign long-term investment in U.S.	222	297	448	379
Total	820	958	1,429	1,894
Net payments on foregoing items	5,613	5,644	8,669	8,615
<i>Memorandum items</i>				
Reported U.S. private short-term investment abroad ^f	163	247	1,382	626
Unrecorded payments (errors and omissions)	(345) ^g	(338) ^g	597	696

^a Excludes ordinary government operations, such as expenditures of the diplomatic service.

^b Seasonally adjusted, preliminary data.

^c Excludes unscheduled debt repayments to the U.S. Government (see Tables 1 and A-4).

^d Includes a rough allowance for receipts from military transactions in 1950-1952 (not separately reported in those years).

^e Includes deliveries on military sales during the period and \$360 million (annual rate) transferred to restricted accounts with the U.S. Treasury on military purchases to be made by foreign countries.

^f Less changes in foreign commercial credits to the United States.

^g Net receipts.

SOURCE: U.S. Department of Commerce.

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imposed the need for a much faster rate of growth in exports than in imports, not merely an increase sufficient to close the deficit on basic transactions which had already developed. If, for instance, imports of goods and nonmilitary services had risen by 50 per cent from the 1953-1955 level—or slightly less than the actual increase to the first half of 1962—exports of goods and nonmilitary services would have needed to increase by about 65 per cent, the relevant computations being as follows (in millions of dollars):

Assume an increase of 50 per cent in imports of goods and nonmilitary services from the 1953-1955 annual average of 14,000 (Table 14)	7,000
Add: actual increase to first nine months of 1962 in annual rate of net government expenditures abroad, private long-term investments, and remittances and pensions (Table 7)	3,000
Add: deficit on basic transactions in 1953-1955, annual average (Table 6)	1,700
Equals: additional exports of goods and nonmilitary services needed over 1953-1955 annual average of 18,000; that is, an increase of 65 per cent	11,700

Because exports of goods and nonmilitary services in 1953-1955 were already so much larger than corresponding imports, a 50 per cent increase in both would have sufficed to eliminate the deficit on basic transactions in the absence of a rise in the expenditures listed in Table 7. But, with the increase in these expenditures, an appreciably faster rate of growth in exports has been needed—a need only partially fulfilled so far, as will be discussed in Section 4 of this chapter.

If it were considered also necessary to cover, rather than curb, outflows of liquid capital on the scale experienced in 1960-1961, the required increase in exports of goods and nonmilitary services over the 1953-1955 level, under the conditions stated above, would have been more than 75 per cent (the additional amount being the net change of \$2,070 million in the memorandum items given at the bottom of Table 7).⁵ In absolute amount, the increase needed in exports (\$13,800 million) would have been almost twice as great as that

⁵In this computation it is assumed that the shift in unrecorded transactions can be attributed to movements of liquid capital. See pp. 16-17.

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assumed in imports of goods and nonmilitary services.⁶

It may be useful to stress again a point mentioned in Chapter I, namely, that the various expenditures abroad listed in Table 7 and the trade surplus are not independent of each other. Thus, the greater part by far of government grants and credits is directly spent on United States goods and services, including deliveries of farm products under our surplus disposal programs.⁷ This is also true of a part, albeit a smaller part, of our private investments abroad insofar as disbursements are made for the procurement of equipment and materials in the United States. To the extent that this is so, it may ease the "transfer problem"—that is, the problem of developing an export surplus to compensate for the rise in government expenditures and private investment abroad.⁸ It is possible, however, to exaggerate the extent of the relief afforded by a deliberate policy of tying foreign economic aid to purchases here: if the beneficiary countries' high-priority demands for United States goods are financed in this way, they then have greater leeway to apply their own foreign exchange earnings to the satisfaction of their demands on other sources of supply. In other words, the net effect on the United States balance of payments is not necessarily different in all cases when economic aid is tied and when it is not.⁹ In any event, it seems clear that the greater part of the net figure of \$8.6 billion shown in Table 7

⁶ This puts the problem in an extreme form, but, as further noted subsequently, something would need to be allowed for the exports made possible by short-term credits extended by this country.

⁷ See Chart 1. The funds may also be used in part to refinance outstanding obligations to the United States.

⁸ The "transfer problem" was the subject in 1929 of a lively controversy between Keynes and Bertil Ohlin in the *Economic Journal* with regard to Germany's ability to pay reparations growing out of the First World War. Their articles, along with a 1942 commentary by Lloyd A. Metzler, are reprinted in *Readings in the Theory of International Trade*, Philadelphia, 1950. In connection with the policy of tying U.S. government expenditures to procurement in the United States, it is interesting to recall Ohlin's concluding comment: "In principle, the safest and simplest way of organizing the reparation payments would be a policy of deliveries in kind from Germany to France and the South American nations, which require imports of many commodities German industry is well able to produce." Ohlin foresaw as a major obstacle, however, "the inevitable opposition of powerful American and British export industries" (*ibid.*, p. 178).

⁹ For a discussion of some of these complex relations, see *Survey of Current Business*, September 1961, pp. 9-12, and June 1962, pp. 15-24.

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accrues to other countries as part of their freely usable foreign exchange resources and is employed in accordance with the dictates of market and other forces. The United States has therefore needed to strengthen its competitive position to accommodate these payments.

3. Factors of Change in Our Competitive Position

GROWTH OF FOREIGN CAPACITY AND ELIMINATION OF BOTTLENECKS

At the same time that our financial commitments were rising over the past decade, some important supports to our export surplus were falling away. The swift growth of production in Europe and Japan, along with the reduction in excess purchasing power through monetary reform and price increases, brought supply and demand into better balance in these countries, making them less dependent on the United States as a source of supply and increasingly able to compete with it.

These changes bore more heavily on some parts of our trade than on others, and it may be useful to note some of their specific effects on products of considerable prominence in our exports. Thus, for some years after the war, energy was a bottleneck abroad. Coal was in short supply, the construction of oil refineries was only beginning, and electric power generating capacity had fallen far behind demand. As another example, Europe had lagged badly behind the United States in the development of continuous strip mills, and sheet steel production was until very recently inadequate to meet the needs of the booming automobile industry. These conditions created heavy demands on the United States in Europe and Japan, and also in third markets, for fuels and industrial materials as well as for capital equipment for their production. One by one these shortages disappeared, and with them the exceptional support which they had provided to United States exports.¹⁰

INCREASED RECEPTIVITY OF THE UNITED STATES TO IMPORTS

Still another major change affecting our trade and payments position is that the United States is much more open to foreign competition today than at any time in recent decades. Sir Donald MacDougall has

¹⁰ In this connection, note especially the behavior of the items in Group I of Table 2 and the discussion on p. 30.

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pointed out that, for a succession of reasons, the United States was largely sheltered from imports of manufactures over most of the last thirty years or more.¹¹ The inhibiting factors included our high tariffs of the interwar period, the stultifying effects of the depression in the 1930's, the disruption of normal trade during the war years, the early postwar shortages in other countries, and the time they required to rebuild export outlets.

Now, for the first time in many years, other manufacturing countries have both the possibility and the incentive to compete in the American market. Our import duties are much lower over a broad range of goods, both because of actual reductions in rates of duty from those set in the 1930 tariff and because the rise in prices since then has diminished the effect of specific duties. Our merchants have become active in seeking out foreign suppliers, even to the extent of initiating production and providing technical help, and foreign styling and a foreign label have a wider appeal to customers than before. In these circumstances the selling drives launched by foreign countries in the days of the dollar shortage are bearing fruit.

The recent rapid growth of United States imports of manufactures may therefore represent the concentration in a few years of a development that, without the inhibiting circumstances mentioned, might well have stretched out over several decades and permitted more leisurely adjustment in our trade and payments.

FOREIGN TECHNOLOGICAL ADVANCE

Many of our manufactures, even if sometimes costly, sell on the basis of the advanced technology which they embody. A few years ago a Danish economist, Erik Hoffmeyer, developed the thesis that United States imports consisted mainly of traditional commodities, while its exports consisted increasingly of new and research-intensive products.¹² These included, in particular, machinery and vehicles, chemicals, synthetic fibers, scientific and professional instruments, and photographic goods. Hoffmeyer's recapitulation of our export statistics showed that the share of these groups in our total exports had increased from 12 per cent just before the First World War to 24 per cent in the late 1920's and to 44 per cent in 1953-54.

¹¹ *The Dollar Problem: A Reappraisal*, pp. 41-42.

¹² *Dollar Shortage and the Structure of U.S. Foreign Trade*, Copenhagen and Amsterdam, 1958.

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As noted earlier in this chapter, this characteristic of our exports figured prominently in the expectation widely held only a few years ago that the rest of the world was likely to face continuing difficulty in balancing accounts with the United States. Even if our production costs were high, it was said, other countries were bound to be avid customers for the latest products of our advanced technology. Some of these would eventually be put into production abroad, but meanwhile the United States would enjoy a lead in their sale and would be developing other more advanced products to take their place. Nowadays, this argument is used in reverse to explain the present oversupply of dollars.¹³ Other countries, it is said, have also been making rapid strides in their technology and, in a general climate of growth and innovation, are reducing our leadtime in industrial application. This process is aided by the growth of United States manufacturing and licensing operations abroad which incorporate our latest technology, and many American companies are now also engaging in original research and development activity in other countries.

In this view, therefore, the competitive conditions in world trade have drastically altered, with effects on both our exports and our imports, and the United States must increasingly be prepared to compete on a price basis and to make whatever adjustments in its cost and price levels may be necessary to this end.

While recognizing the technological strides being made by our competitors, one may ask if there is not some risk of underrating our own progress. Expenditures on research and development in the United States are estimated to have doubled in real terms, or trebled in money terms, from 1953 to 1961 to a total of approximately \$15 billion, or one-third as much as business expenditures on fixed capital. Though more than 55 per cent of the total is accounted for by the aircraft and parts industry and the electrical equipment and communications industry, indicative of the role of defense contracts, research and development outlays have been increasing rapidly in other industries as well.¹⁴ It

¹³ Cf., for example, Charles P. Kindleberger, "United States Economic Foreign Policy: Research Requirements for 1965," *World Politics*, July 1959, and Albert O. Hirschman, "Invitation to Theorizing About the Dollar Glut," *The Review of Economics and Statistics*, February 1960.

¹⁴ *Economic Report of the President*, January 1962, pp. 123-127 (based on statistics compiled by the National Science Foundation). See also National Science Foundation, *Funds For Research and Development in Industry, 1957, 1958, 1959*, Washington, 1960, 1961, 1962, pp. 73, 51, and 53, respectively.

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seems likely that the part devoted primarily to defense purposes may also yield a significant return in technological progress of civilian application.¹⁵

A recent British study undertook to compare the amount of expenditure on research and development performed by industry, including that financed by the government, in the United States and the United Kingdom in 1959, and summed up its findings as follows:

After adjusting the exchange rate to get a comparison which is, as near as possible, in real terms, it seems that American industry's research expenditure is over five times as large as British industry's, as an absolute figure; it is nearly three times as large per employee, and twice as large as a percentage of net output. Taking the 350 largest firms in each country which do research, the average large American firm spends five times as much as the average large British one.¹⁶

Though these data on the increase and relative size of research and development expenditures in the United States are reassuring as far as they go, they need to be supplemented by more thorough investigation into the factors bearing on our competitive position in technologically advanced products. It may be, for instance, that industrial research efforts in the United States are unduly focused on getting quick market results, in contrast to basic research leading to new

¹⁵ A skeptical view on this subject is expressed in *The Nation's Engineering Research Needs 1965-1985*, Summary Report of the Engineering Research Committee, Engineers Joint Council, May 25, 1962. In its conclusions the report expresses the view that "The present system for allocating resources to U.S. research and development programs is producing an apparent imbalance in our technical effort, with emphasis on defense-atomic-space activities and on the rapid exploitation of new scientific developments, with an accompanying relatively complete neglect of basic need-oriented engineering programs." It further states that "the nondefense agencies of the Federal government do not have adequate research programs," and that "industries which have little contact with defense programs tend to provide minimal support for research and development, suggesting that they are not able to compete with Federal research and development programs, or that they are organized in such a way that they cannot undertake research and development as it is performed today."

¹⁶ "Research and Development: A Comparison Between British and American Industry," *Economic Review* (London, National Institute of Economic and Social Research), May 1962, pp. 21-39. It may be noted that the study employs a "research" exchange rate of \$6.30 to the pound (compared with the official rate of \$2.80), reflecting chiefly the much higher level of salaries of scientists and engineers in the United States. Costs of materials, according to the study, "are not much—if at all—more expensive in the United States."

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scientific discoveries and technological innovations.¹⁷ At the same time one may ask if the role of research as an independent economic factor may not be overstated in relation to other influences, such as growth of incomes and markets, contributing to the development of modern large-scale industry in other countries and to the increase in their competitive power in "research-intensive" products.¹⁸

PRICES AND COMPETITION

In its most general formulation, the judgment that United States prices are too high does not rely on statistical evidence of differences in prices or price movements at home and abroad but only on the fact of the deficit itself. By this test—whatever the relative magnitude of past inflation indicated by international comparisons extending back to some base period—United States prices are at a level higher than would be compatible with the growth in its foreign commitments and the increase in the productive power and financial discipline of its competitors.¹⁹

It is important but difficult to proceed beyond this very broad statement and to form a judgment as to how serious the disparity between United States and foreign prices may be. Actual export price quotations from both home and foreign sources are few and difficult

¹⁷ This criticism is strongly expressed in a paper, "The Role of Research and Engineering Effectiveness in World Chemical Competition," presented by P. W. Blaylock on December 7, 1961, at the Annual Meeting of the American Institute of Chemical Engineers. Mr. Blaylock contrasted the "commercially oriented company" and the "scientifically oriented company," and complained that "the money reported as having been spent on 'research' is no measure of the fruitfulness of the work which was done. . . . Vast sums are spent on 'modifying, refining, testing and perfecting' other peoples' inventions as soon as they have become fashionable. All goes well until the supply of these inventions runs short. Then profits suffer and the basic weakness of the commercially oriented firm is exposed." In his conclusions Mr. Blaylock said: "We learned that an organization which can manufacture and sell with great efficiency can, nevertheless, be intellectually sterile. Finally, we saw that an increase in the amount of money spent on research and an increase in the number of scientists employed will not ensure an increased flow of inventions. Small, modest groups of scientists can turn out a creditable flow of inventions if they work in the right environment. It is the North American corporate climate which is at fault. This is what must be corrected if we are to improve the efficiency of our research in the future."

¹⁸ Cf. Irving Kravis, "'Availability' and Other Influences on the Commodity Composition of Trade," *Journal of Political Economy*, April 1956.

¹⁹ Cf. Gottfried Haberler, "Domestic Economic Policies and the United States Balance of Payments," in Seymour E. Harris (ed.), *The Dollar in Crisis*, New York, 1961, pp. 63-65.

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to compare, especially for the highly fabricated and differentiated products in which we are most interested. It is hoped that information in this vital area will be greatly improved by the intensive investigation into comparative prices and related factors in the United States and abroad which the National Bureau has undertaken.²⁰

More information is available on relative price changes as measured by the various price indexes compiled in each country. We may therefore hope to get at least some idea of how far prices have altered to our disadvantage during, say, the past decade, even though we still lack any solid basis for judging our comparative price position at any point of time. Tables 8 and 9 give national wholesale and consumer price indexes and the implicit price deflators of gross national products for a number of countries. These indexes are, however, subject to serious shortcomings because of differences in composition and methodology, and they are heavily weighted with products which do not enter foreign trade. The latter difficulty is obviated by the so-called "unit value" indexes given in Table 10 for United States exports and imports and in Table 11 for exports of manufactures by the United States and other industrial countries. Such "unit value" indexes suffer, however, from other grave deficiencies. They either cover only a small and not necessarily representative part of trade in manufactured goods or contain heterogeneous commodity aggregates for which changes in unit values may reflect shifts in composition or quality rather than price changes.²¹

Because of the deficiencies in these various measures, they do not lend themselves to firm conclusions about the relative course of United States and foreign prices. The rise after 1953 in the general level of prices does not appear to have been markedly greater, if at all, in the United States than in most other leading industrial countries.²²

²⁰ See the Preface to this paper for further comments on the new project.

²¹ For a critical appraisal of "unit value" indexes, see *The Price Statistics of the Federal Government*, New York, NBER, 1961, pp. 79-86, and Robert E. Lipsey, *Price and Quantity Trends in the Foreign Trade of the United States* (in press).

²² This conclusion seems to emerge clearly from the implicit price deflators in Table 9 for total gross national product and for personal consumption, and to be supported also by the movements of the consumer price indexes in Table 8. The wholesale price index, on the other hand, rose more, especially up to about 1959 or 1960, in the United States than in other industrial countries, the United Kingdom and Sweden being important exceptions (and France also except as offset by devaluation of the franc).

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TABLE 8

**INDEXES OF WHOLESALE AND CONSUMER PRICES, U.S. AND
OTHER INDUSTRIAL COUNTRIES
(1953 = 100)**

		1957	1958	1959	1960	1961	1962 October
United States							
Wholesale prices	A	106.8	108.3	108.4	108.6	108.2	108.6
Consumer prices	A	105.0	107.9	108.9	110.6	111.8	113.7
Belgium							
Wholesale prices	A	106.3	101.7	101.3	102.6	102.4	101.7 ^a
Consumer prices	A	106.9	108.3	109.6	110.0	111.1	112.7
France							
Wholesale prices	A	108.2	120.7	126.5	129.7	132.4	135.1
	B	103.0	100.5	89.7	92.0	93.9	95.8
Consumer prices	A	105.5	121.5	128.9	133.6	137.2	145.7
	B	100.5	101.2	91.4	94.8	97.3	103.4
Germany, Fed. Rep.							
Wholesale prices	A	} 103.4	103.0	102.2	103.4	104.9	106.3
	B					{ 109.3	111.6
Consumer prices	A	} 106.6	108.8	109.9	111.5	114.3	118.1
	B					{ 119.1	124.3
Italy							
Wholesale prices	A	102.7	100.9	97.9	98.8	99.0	102.2 ^a
Consumer prices	A	110.2	113.3	112.8	115.4	117.8	124.2 ^a
Japan							
Wholesale prices	A	105	98	99	101	105	105
Consumer prices	A	109	109	110	114	120	129
Netherlands							
Wholesale prices	A	} 107.4	105.2	105.8	103.2	102.5	102 ^b
	B					{ 106.8	107 ^b
Consumer prices	A	} 115	117	118	121	123	128 ^a
	B					{ 128	135 ^a
Sweden							
Wholesale prices	A	110	107	107	111	113	115 ^a
Consumer prices	A	113	119	120	124	127	134
Switzerland							
Wholesale prices	A	105.1	101.8	100.2	100.8	101.0	104.1
Consumer prices	A	105.1	107.2	106.4	107.9	110.0	115.5
United Kingdom							
Wholesale prices	A	110.7	111.4	111.8	113.3	116.3	119.4
Consumer prices	A	115.8	119.3	120.0	121.2	125.3	130.4

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NOTES TO TABLE 8

A = Indexes of price changes in national currencies.

B = Indexes of price changes expressed in dollars where exchange parities have altered.

^a September.

^b August.

SOURCE: Japan, United Nations, *Monthly Bulletin of Statistics*, July 1961, p. 144, and December 1962, pp. 120-121 and 144-145; other countries, OECD Statistical Bulletins, *Main Economic Indicators*, November 1962, p. 12.

This generalization does not hold, however, for capital goods and related items which are of crucial importance in United States foreign trade. In particular, prices of machinery and steel appear to have risen much more here than in Europe during the 1955-1959 period, as reflected in the price deflators for machinery and equipment in Table 9.

Our unfavorable position in steel appears to be borne out by other data²³ and by the course of trade. In machinery, the significance of the comparison is less clear because of differences in types and qualities and because of the strength of our export performance. This strength could mean that the rapid growth of the economies of Western Europe and Japan in recent years has generated a good demand for our machinery, despite the apparently greater increase in United States prices for these products. One would also need to allow, however, for the possibility that the divergencies in reported price trends reflect not only differences in supply prices for the same products but also differences in demand for different products. If, for instance, American production and exports of machinery are more heavily weighted than production and exports of other countries with products of advanced technology for which world demand has been particularly strong, the relatively greater increase in United States price indexes, so weighted, would not necessarily measure a deterioration in its competitive position.

Since about 1959, there seems to have been no further increase, and perhaps rather some decrease, in United States prices compared

²³ On the basis of unweighted averages of indexes of four types of steel (bars, plates, sheets, and structurals) given in a study by Hang Sheng Cheng, steel prices increased 20 per cent from 1953-1957 both in the United States and in the European Coal and Steel Community, and then rose by a further 5 percentage points to 1959 in the United States but fell by some 20 per cent in the ECSC ("Relative Movements in the Prices of Exports of Manufacturers: United States Versus Other Industrial Countries, 1953-59," *IMF Staff Papers*, March 1962, p. 80).

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TABLE 9

IMPLICIT PRICE DEFLATORS FOR GROSS NATIONAL PRODUCT AND
SELECTED COMPONENTS, UNITED STATES AND EUROPEAN MEMBERS OF OECD
(1953 = 100)

		1955	1957	1959	1960	1961
<i>Gross national product, total</i>						
United States	A	102	109	114	115	117
OECD, excl. U.S. and Canada ^a	B	104	111	110	113	118
Belgium	A	102	111	112	114	115 ^p
France	A B	} 102	{ 113 106	134 96	139 99	144 103
Germany, Fed. Rep.	A B	} 102	109	115	118	{ 123 129
Italy	A	104	109	111	113	115
Netherlands	A B	} 108	119	122	124	{ 126 132
Sweden	A	104	113	118	123	126
United Kingdom	A	106	116	121	123	127
<i>Capital formation, total</i>						
United States	A	103	115	118	120	120
OECD, excl. U.S. and Canada ^a	B	102	110	108	110	115
Belgium	A	103	115	116	118	118 ^p
France	A B	} 101	{ 113 105	127 91	130 93	133 95
Germany, Fed. Rep.	A B	} 102	109	113	118	{ 124 129
Italy	A	102	108	107	108	111
Netherlands	A B	} 107	122	123	124	{ 125 131
Sweden	A	102	111	112	119	123
United Kingdom	A	105	114	116	116	119

(continued)

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TABLE 9 (concluded)

		1955	1957	1959	1960	1961
<i>Capital formation: machinery and equipment</i>						
United States	A	104	117	122	123	122
OECD, excl. U.S. and Canada ^a	B	101	107	105	106	110
Belgium	A	102	113	113	115	115 ^p
France	A } B }	99	{ 107 100	123 88	127 90	130 93
Germany, Fed. Rep.	A } B }	98	105	105	107	{ 110 115
Italy	A	98	103	100	100	102
Netherlands	A } B }	100	110	109	110	{ 110 115
Sweden	A	98	109	109	116	119
United Kingdom	A	104	115	118	118	122
<i>Personal consumption, total</i>						
United States	A	101	106	110	111	112
OECD, excl. U.S. and Canada ^a	B	104	109	107	110	113
Belgium	A	102	108	109	109	110 ^p
France	A } B }	103	{ 113 105	133 95	138 98	143 102
Germany, Fed. Rep.	A } B }	103	108	112	114	{ 117 122
Italy	A	104	109	110	111	112
Netherlands	A } B }	106	113	116	118	{ 120 126
Sweden	A	104	112	116	120	123
United Kingdom	A	106	114	118	119	122

A = Indexes of price changes in national currencies.

B = Indexes of price changes expressed in dollars where exchange parities have altered.

^a Includes, in addition to European countries listed, Luxembourg, Austria, Denmark, Greece, Iceland, Ireland, Norway, Switzerland, Portugal, and Turkey.

^p Preliminary estimate.

SOURCE: From data supplied by the OECD.

TABLE 10

U.S. EXPORT AND IMPORT "UNIT VALUE" INDEXES AND EXPORT-WEIGHTED
INDEXES DERIVED FROM COMPONENTS OF WHOLESALE PRICE INDEX

	Index Numbers (1953 = 100) ^a					
	1955	1957	1959	1961	First Quarter	1962 Second Quarter
Average Value of Exports or Imports 1957-1959 (millions of dollars)						
<i>"Unit value" indexes</i>						
<i>Exports, total^b</i>	18,628	106.4	106.4	109.6	111.7	109.6
Finished manufactures	11,101	110.1	114.6	120.2	122.3	121.3
Semimanufactures	2,671	106.5	105.4	104.3	104.3	101.1
Finished manufactures and semimanufactures ^c	13,773	101.3	112.8	117.1	119.0	117.4
<i>Imports, total^b</i>	13,948	102.0	105.1	99.0	97.0	97.0
Finished manufactures	4,204	99.0	102.0	103.0	101.0	102.0
Semimanufactures	2,962	105.2	109.3	101.0	97.9	96.9
Finished manufactures and semimanufactures ^c	7,166	101.6	105.0	102.2	99.7	99.9
<i>Export-weighted indexes derived from WPI components^d</i>						
1. Machinery and vehicles	6,540	104.4	118.9	124.3	124.5	124.4
2. Metals and manufactures	1,751	107.7	119.3	121.1	120.5	119.8
3. Chemicals and related products	1,424	100.8	103.6	104.1	103.1	101.7
4. Sawmill products and wood manufactures	133	102.9	99.1	104.7	96.5	97.7
5. Pulp and paper products	322	102.7	111.6	113.9	111.4	113.0
6. Rubber and manufactures	304	114.9	116.1	115.5	111.4	107.8

(continued)

TABLE 10 (concluded)

	Average Value of Exports or Imports 1957-1959 (millions of dollars)	Index Numbers (1953 = 100) ^a					
		1955	1957	1959	1961	1962 First Quarter Second Quarter	
7. Textile semimanufactures and finished manufactures	634	98.0	98.1	97.7	97.0	97.7	97.9
8. Petroleum and products	677	99.4	112.5	102.0	105.0	103.1	103.9
9. Coal and related products	589	92.9	110.3	108.6	106.8	107.9	103.7
10. Manufactured foodstuffs	1,114	97.2	100.9	102.3	103.7	104.8	102.9
11. Crude foodstuffs and other agricultural materials	2,926	92.4	93.7	91.8	90.7	92.7	90.8
12. Miscellaneous products (mainly manufactures)	1,185	94.0	91.7	96.7	98.6	100.2	100.6
Total, all groups (1 to 12)	17,599	100.6	108.9	110.9	110.7	111.1	110.4
Total, excluding miscellaneous (1 to 11)	16,414	101.1	110.2	111.9	111.6	111.8	111.2
Manufactures, including miscellaneous products (1 to 7 + 12)	12,293	103.3	113.0	116.8	116.6	116.6	116.5
Manufactures, excluding miscellaneous products (1 to 7)	11,108	104.3	115.3	118.9	118.5	118.4	118.2

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NOTES TO TABLE 10

^a Converted from 1957-1959 base as published in sources indicated.

^b "Unit value" indexes for total exports and total imports include (in addition to finished manufactures and semimanufactures) crude materials, crude foodstuffs, and manufactured foodstuffs.

^c The separate indexes for "finished manufactures" and semimanufactures" are combined (according to their weights as given in the first column) for closer, but still imperfect, comparability with the series for exports of "manufactures" as defined in Table 11.

^d Indexes given in the last four lines of the table have been obtained by applying weights derived from the export values shown in the first column to the following groups or subgroups of the wholesale price index, numbered as in the stub: (1) machinery and motive products; (2) metals and metal products; (3) chemicals and allied products; (4) lumber and wood products; (5) pulp, paper, and allied products; (6) rubber and products; (7) textile products and apparel; (8) petroleum products, refined; (9) coal; (10) processed foods; (11) farm products; (12) miscellaneous.

SOURCE: U.S. Department of Commerce and Bureau of Labor Statistics.

with those of most other countries. The further increase since 1959 in the United States "unit value" index for exports of manufactures is, however, puzzling. Though little or no greater than in the corresponding series in Table 11 for other industrial countries except Italy and Japan, this increase appears out of line with the behavior of both the United States wholesale price index and the price deflator for machinery and equipment. This difference in movement has prompted the construction of crude export-weighted indexes derived from components of the United States domestic wholesale price index in the manner indicated in the lower part of Table 10. The indexes shown for manufactures (last two lines of the table) conform fairly well to the general movement shown by the "unit value" series for manufactures up to 1959, but exhibit marked stability since then in contrast to the continued rise in the export "unit value" series—a divergence which, on the surface, appears implausible in view of the intensified competition which has developed in international trade. Here again, more detailed research is needed, but this comparison would appear to cast doubt on the reliability and international comparability of the "unit

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TABLE 11

**"UNIT VALUE" INDEXES OF EXPORTS OF MANUFACTURES,
UNITED STATES AND OTHER INDUSTRIAL COUNTRIES^a
(1953 = 100)**

	1955	1957	1959	1960	1961	1962 Jan.- Sept.
United States	101	112	116	118	121	122 ^b
Belgium-Luxembourg	96	102	95	95	95	95 ^b
France	100	104	94	99	100	99 ^b
Germany, Fed. Rep.	96	101	99	100	105	107
Italy	92	90	80	83	80	n.a.
Japan	91	97	93	94	91	89
Netherlands	98	103	101	101	105	n.a.
Sweden	100	107	108	110	113	112
United Kingdom	101	108	110	113	114	115

^a National series converted to dollar equivalent where exchange rates have altered. "Manufactures" comprise, in principle, Sections 5 to 8 of the Standard International Trade Classification and differ to some extent in coverage from any of the series given in Table 10.

^b January-June.

SOURCE: Statistical Office of the United Nations.

value" indexes in Table 11.²⁴

Perhaps more important than price indexes as a guide to the future, there is evidence that our cost position vis-à-vis other countries

²⁴ These questions are of some importance, given a common tendency to pay homage to the imperfections of the "unit value" series and then nevertheless to draw conclusions from them. It must be remembered that the "price" data for these indexes are derived by dividing (where both are available) reported values by reported quantities for individual items in the trade statistics. Even though great care may be exercised in the selection of items, as in the computation of the U.S. series, one may doubt that a representative sample can be obtained in this way, especially with regard to highly developed manufactures for which significant physical measures are usually lacking. These doubts apply, of course, not only to the U.S. indexes but also to those for other countries.

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has also improved over this period. In the United States labor costs per unit of output in manufacturing seem to be no higher, on the average, than in 1957, the increase in hourly earnings being offset by the rise in output per manhour. For some of our leading competitors, on the other hand, the labor market has become very tight, especially for skilled workers, and, as may be seen in Table 12, labor costs per unit of output are tending to rise.²⁵

In Western Germany, perhaps the most important case in point, productivity gains are no longer outdistancing wage increases. From the second quarter of 1960 to the second quarter of 1962, hourly earnings in German industry rose by almost one-fourth, or more than two and a half times as much as the rise in output per manhour over this period.²⁶ If we also take account of the 5 per cent revaluation of the mark in March 1961, wage costs per unit of output in German manufacturing were about 20 per cent higher, in dollar terms, in mid-1962 than two years earlier. Even if German producers absorb the difference, these increases should do something to shift the relative attractions of the internal and external markets and to adjust the balance of trade. Complaints about the profits squeeze in the United States now have a familiar echo in Germany and other Western European countries.

It seems likely that these upward pressures on European labor costs will continue. Additions to the labor force will be smaller in some countries for demographic reasons, and potentially large transfers out of agriculture may be inhibited by the high prices to be paid to farmers under the policies agreed upon by the Common Market. Having already become accustomed to high annual wage increases, European labor is in a strong position, under these conditions, to press its objectives, including that of shorter hours with no reduction in pay. Within the

²⁵ Different results are obtained for the United States, especially in computing the change in labor costs from 1953 to 1957, depending on whether manufacturing output is measured by the Federal Reserve index of production or by the Bureau of Labor Statistics series on net output in manufacturing. (For a summary discussion of the differences between these series see the *Survey of Current Business*, October 1962, pp. 17, 18.) This difference in results is indicative of the problems encountered in measuring unit labor costs in any one country and of the uncertainty attaching to international comparisons of the results for different countries.

²⁶ The increase in hourly earnings refers to all German industry, that in output per manhour to manufacturing industry only. See *Economic Review* (National Institute of Economic and Social Research, London), November 1962, Table 22, p. 59.

TABLE 12

PERCENTAGE CHANGE IN LABOR COST PER UNIT OF OUTPUT IN MANUFACTURING IN THE UNITED STATES AND OTHER LEADING INDUSTRIAL COUNTRIES, 1953 TO 1957 AND 1957 TO 1961

Line	Country	1953 to 1957			1957 to 1961		
		Output per Manhour or per Man(°) (1)	Labor Cost per Hour or per Man(°) (2)	Labor Cost per Unit of Output ^a (3)	Output per Manhour or per Man(°) (4)	Labor Cost per Hour or per Man(°) (5)	Labor Cost per Unit of Output ^a (6)
<i>All Employees</i>							
United States, with output measured by:							
1.	BLS index	7	22	13	14	16	2
2.	FRB index	13	22	8	15	16	1
3.	France	40	52	{ 9 1 ^b	26	37 ^c	{ -15 ^b -3
4.	Japan	31	22	-7	35	30	-1
5.	Netherlands	15 ^e	50	30	20 ^e	19	-4 ^d
6.	United Kingdom	10 ^e	31 [*]	18	10 ^e	24 [*]	13
<i>Production Workers</i>							
United States, with output measured by:							
7.	BLS index	13	20	6	18	14	-4
8.	FRB index	18	20	2	19	14	-4
9.	Germany, Fed. Rep.	24	34	8	28	41	{ 10 15 ^d
10.	Italy	30 ^e	24	-5	22 ^e	19 ^c	-2
11.	Sweden	13 ^e	31	16	15 ^e	28	11
12.	United Kingdom	13 ^e	31 [*]	16	13 ^e	23 [*]	9

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NOTES TO TABLE 12

SOURCE: For all except lines 2, 6, 8, and 12: Computed by the Bureau of Labor Statistics, Department of Labor, from sources indicated in Tables C-3 and C-4 of the paper "Foreign Trade and Collective Bargaining" delivered by Philip Arnow, Assistant Commissioner of Labor Statistics, to the Industrial Relations Research Association, Detroit, May 1960. The Bureau of Labor Statistics notes that it is not in a position to determine the comparability or reliability of the basic statistics from which these unit-labor cost indexes were derived. The calculations should be regarded as tentative estimates which have required various assumptions or projections and which may therefore be subject to error. Adjustments have been made by the BLS to include wage supplements in the labor cost data given in columns 2 and 5.

Lines 2 and 8: NBER computation, employing Federal Reserve index of manufacturing production instead of Bureau of Labor Statistics index of net output in manufacturing to derive entries for columns 1, 3, 4, and 6.

Lines 6 and 12: NBER computation based on data given on manufacturing output, number of wage earners and salary earners employed in manufacturing, and total wage bill and salary bill in manufacturing in Tables 14 and 17 of *National Income and Expenditure 1962*, London.

^a Where output is given per man (°) and labor cost per manhour, the assumption is made that the latter moved in the same way as labor cost per man (i.e., that there has been no change in hours worked).

^b Equivalent in dollar terms, reflecting devaluation of the French franc by approximately 16.7 per cent in August 1957 and by a further 15 per cent in December 1958.

^c Preliminary.

^d Equivalent in dollar terms, reflecting upward revaluation of the German and Dutch currencies by 5 per cent in March 1961.

^e According to an index published by the National Institute of Economic and Social Research, London, output *per manhour* worked by all employees in manufacturing rose by 9 per cent from 1953 to 1957 and by 13 per cent from 1957 to 1961 (*Economic Review*, November 1962, Table 8, p. 52).

Common Market there is also strong pressure, especially from France, for equal pay for women, now substantially lower than men's wages in other countries of the group.

AMERICAN INVESTMENT IN FOREIGN MANUFACTURING

The growth of American foreign investment, or more specifically that part of it going into manufacturing operations in Western Europe, deserves further attention with respect to both its implications and its consequences for the international competitive position of the United States.

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Apart from the present and future effects of these investments on the balance of payments, they are sometimes looked upon as evidence in themselves of differences in production costs between the United States and other countries. On this view, the rapid swelling of American manufacturing operations in Western Europe during the last several years is in itself an indication of weakness in our competitive position vis-à-vis other industrial countries.

One cannot but be impressed by the breadth and strength of this development of foreign operations by American companies. What it signifies for our competitiveness, however, is not clear. Comparative advantage never lies wholly on one side or the other, else there would be no basis for international trade. It seems plausible to assume that, in the absence of any special deterrents, American firms would be actively investing abroad. It is also evident, however, that until quite recently conditions over most of the last three decades were not such as to encourage American investment in Europe. One has only to recall the economic and monetary disturbances associated with the Great Depression of the early 1930's, the growing political and military tensions as the war approached, five years of active warfare in Europe, and then the early postwar years of shortages and controls and still several years more until, at the end of 1958, European currencies were once again convertible. World political uncertainty is perhaps greater than ever, and yet, here too, the development of nuclear weapons tends to equalize military risks and to remove whatever preference the United States may have enjoyed in relative security. Perhaps, then, American companies are now crowding into a few hurried years the expansion of their foreign manufacturing operations which, under more propitious conditions, they would have developed over the last several decades.

This concentration, or catching up, of investment activity is true in a larger sense of the impressive growth of the Western European economy in general during the past ten years. This adds to the inducement to American firms, especially those having large funds to invest and limited incentive to spend them on expanding capacity in the more slowly growing American economy. Without minimizing the contribution which economic policies on one side and the other may have made to this disparity in growth rates, a considerable part of it, perhaps the greater part, may be simply attributable to the earlier failure in Europe, under prewar and wartime conditions, to develop industries which in America had already reached high levels of capacity and

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technology. The rapid postwar development of automobile production and transportation in Europe must alone have provided a powerful stimulus to the development of other industries, especially steel, petroleum refining, and highway construction, as well as a host of ancillary manufacturing and service industries in each case.

In this atmosphere of growth in Europe, the Common Market has developed a mystique of its own, coupled with the more tangible attraction to production within the area provided by a common external tariff on imports from outside and the progressive elimination of duties on trade among the members. The inducement to American firms to establish operations abroad, and to reinvest earnings in the further expansion of capacity, may also have been enhanced by lower taxes than in this country, especially when the amount of taxes effectively paid could be reduced by channeling sales and other receipts of foreign subsidiaries to one of the "tax haven" countries.²⁷ The possibilities of

²⁷ In most European countries the income tax rates to which American manufacturing companies are subject appear to be only moderately lower than in the United States. Thus, the Department of Commerce, after noting that in the fiscal year 1957 manufacturing enterprises in the United States paid about 48 per cent of their income in income taxes, gave the following percentages as having been paid by U.S. direct-investment enterprises in Europe on the basis of data reported in the Department's census of foreign investments (*U.S. Business Investments in Foreign Countries*, Washington, 1960, p. 46): Belgium, 27; France, 52; Germany, 40; Italy, 40; Netherlands, 43; United Kingdom, 45. The rates paid may have been of only nominal significance, however, insofar as profits could be shifted from the country of production to Switzerland or some other "tax haven" country. The motivations on the part of the host country in consenting to arrangements entailing such a loss of revenue were discussed in an interpellation in the Dutch Parliament, reported as follows in a study of taxes in relation to foreign investments in the Common Market countries:

"The Common Market countries recognize that this practice of effecting sales through Swiss base companies is being followed. In this connection the Minister of Finance of the Netherlands was reminded in the legislature that, 'as a matter of fact, some big groups are establishing factories in our country, but, besides, have founded sales companies in Switzerland. Obviously, therefore, they wish to take advantage of the cheap rents, the low wages and the peaceful labor conditions in this country but to invoice the articles produced here to selling organizations in Switzerland at the lowest possible prices and then to export these articles through those Swiss sales companies, which means that the major part of the profit will be made in Switzerland.'

"The Minister of Finance was asked whether fiscal concessions were granted which created unequal competition. He replied in the negative stating, in part, 'This is a phenomenon which is known to me, of course, and which I am actually watching with some concern also. A matter to be considered in this connection, however, is that, of course, we can better have a working company here than nothing at all, provided always that—and this is a matter which the Honorable

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doing so have now been curtailed by recent changes in United States tax legislation.²⁸

With regard to the balance-of-payments effects of these investments in European manufacturing, various and opposing influences may be distinguished. For one thing, they can be expected gradually to give rise to a return flow of earnings which—in time—will come to exceed the current rate of outflow of new capital from the United States into such enterprises. It is in this way that we now receive a large flow of income from our varied investments abroad built up over the past.²⁹ The remittance of earnings from current investment activity may be realized only after some years, however, and in the meantime the expansion of foreign manufacturing operations tends to produce both favorable and unfavorable effects on the balance of payments in other respects.

Concurrently with the act of foreign investment, we can discern certain positive consequences for United States exports, including demands for equipment and services as foreign manufacturing facilities are being constructed and demands for parts and materials as the plants begin to operate. In many cases, moreover, foreign manufacturing subsidiaries provide outlets for finished goods from this country to supplement their own more limited range of production. Along with these positive results certain negative effects may also be expected insofar as the expansion of American manufacturing operations abroad, including the development of ancillary supply functions, displaces products that would otherwise be exported from the United States.³⁰ Account must, however, be taken of the possibility that, in the absence of American investment, some of the productive capacity in question would be installed by others, with trade and employment effects on

Deputy, Mr. Hellema has mentioned, I believe—there will not be created an incorrect competitive basis for the new working company or against the existing Dutch industries . . .” (John McCullough, *The Financial Executive, The Common Market and Taxes* [Lybrand, Ross Bros., and Montgomery], New York, 1960, p. 40).

²⁸ See pp. 74-75.

²⁹ Income from foreign investments has been one of the most rapidly growing elements among receipts over the past decade. See Table 6.

³⁰ The displacement of United States exports would tend to be increased (and the working of the price mechanism in international trade would be impeded) in cases where the United States company enters into arrangements with its foreign subsidiaries, or licensees, reserving to the latter the export market or a specified part of it. Such arrangements do not appear to be widespread, though little information is available on the subject.

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the United States similar to those described, but with no return flow of earnings to this country.

It is possible that, in the recent growth of United States manufacturing investments in Western Europe, the expansionary effects on our trade have so far predominated. They may do so in the future, if our foreign subsidiaries prove to be effective export representatives as well as manufacturers. The net effect on our trade and on the balance of payments as a whole will depend in large measure on the over-all patterns which emerge with respect to the disposition of earnings from these new investments—that is, the extent to which they are remitted to the United States compared with the extent to which they are reinvested in the expansion of production facilities abroad. The inducements to invest in Western Europe are, however, very powerful for the various reasons which have been mentioned. We should not, therefore, underestimate the risk that the expansion of American manufacturing operations in this area may be proceeding in greater breadth and speed than would be consistent with our present trade and payments position. This question gains in importance because of the intimate connection which has been noted between these investments and the potential weakening of our role as a major supplier of technologically advanced products.

OFFICIAL MEASURES DIRECTLY AFFECTING BASIC TRANSACTIONS

The various official measures bearing directly on basic transactions have probably had little effect so far, at least prior to 1962, but may be felt increasingly from now on. Such measures tend to be either difficult to organize and execute or, once started, slow to produce results, or both.

It might seem that, in principle, government action could be brought to bear more quickly and effectively in reducing foreign expenditures, either its own or those of the private sector, than in increasing foreign receipts. In practice, the results obtained on the side of expenditures appear to have been modest so far. Apparently the growing urgency of the problems of Latin American and other less developed areas and threats to security in Berlin, Southeast Asia, and elsewhere have countered efforts to save on economic assistance and military expenditures abroad.

Government grants and loans for economic assistance were, in fact, at a rate more than \$1 billion higher in 1961 and the first nine months of

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1962 than two or three years earlier. The balance-of-payments impact of these outlays may have been softened by steps taken to tie procurement more closely to United States goods and services, though the time required for this action to be reflected in actual disbursements is rather long,³¹ and the real effect is, for reasons already noted, difficult to evaluate.³²

On a gross basis, military expenditures abroad have scarcely declined, except by comparison with the unusually high level of \$3.4 billion in 1958. They have continued since then at an annual rate of about \$3 billion. Even after a rigorous attempt to reduce foreign exchange outlays, including those of military and civilian personnel and their dependents, the Department of Defense estimates that gross military expenditures abroad will still total \$2,865 million in fiscal year 1963, a reduction of only \$178 million from fiscal year 1961. Savings on the side of expenditures are therefore expected to make only a modest contribution to the projected reduction of \$1 billion in *net* military spending abroad in 1963.³³

Probably the only action affecting government expenditures abroad that might have given prompt and substantial relief to the United States balance of payments would have been the assumption by Western European countries of a larger share in the costs of the common

³¹ In mid-1962 disbursements were still being made on commitments undertaken before aid by the Development Loan Fund was tied in the fall of 1959.

³² See p. 51.

³³ Announced as "a prime objective" by the Secretary of Defense on July 16, 1962. The Secretary further indicated that the reductions projected were expected to bring the net figure down to \$1.6 billion by fiscal year 1963 and to \$1 billion by fiscal year 1966. In testimony before the Joint Economic Committee on August 17, the Secretary of the Treasury indicated that the achievement of these targets would require "the full cooperation of our allies." More detailed figures on the targets were given on December 12, 1962, by Assistant Secretary of Defense Charles J. Hitch in testimony before the Subcommittee on International Exchange and Payments of the Joint Economic Committee. These figures show that the major contribution to the 1963 target is expected through an increase from \$375 million to \$1,244 million in U.S. military receipts (including "shipment of military supplies procured through the Department of Defense, reimbursement to the U.S. for logistical support of United Nations and other nations' defense forces and other sales of goods and services by the military departments"). Of the projected saving of \$178 million in U.S. gross military outlays abroad, one-half would be in the operations of the "AEC and other agencies included in NATO definition of defense expenditures"; the other half would come chiefly from reductions in Department of Defense expenditures on its own construction programs abroad and on procurement and construction activities under the Military Assistance Program, offset in part by increases in various other items.

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defense. A view on the adequacy of United States efforts in this regard goes well outside the scope of economic analysis and involves a nice judgment as to the real bargaining power of the leader of a rather loose and dissident alliance. The alternative of reducing American military forces in Europe would also imply a considered judgment on the ultimate political and military consequences of such a decision.

The possibilities for saving on civilian expenditures abroad by increasing customs duties or imposing quotas on imports are limited by the various commitments which we have undertaken in the interest of opening markets to our exports.³⁴ The risk of retaliation by other countries must also be kept in mind. A recent example was given when the Common Market countries doubled duties, effective August 1, 1962, on imports of a number of important items from the United States, but not on imports from other GATT members, in retaliation for the President's escape-clause action doubling U.S. duties on imports of sheet glass and wool carpeting.³⁵

One of the few other possibilities for reducing private outlays abroad has involved proposals to change the rules governing taxation of foreign income. In April 1961 the administration proposed the elimination of deferral of tax with respect to the retained earnings of foreign subsidiaries operating in developed countries. It emphasized in this regard the need to reduce incentives to foreign investment afforded by operations in "tax havens" such as Switzerland. In October 1962, some nineteen months after the original proposal was made,

³⁴ Article II of the General Agreement on Tariffs and Trade provides that imports of items which have been the subject of negotiated concessions (i.e., reductions or bindings of import duties) under the Agreement shall be exempt from ordinary customs duties in excess of the negotiated rates. Articles XI and XII have the effect of prohibiting the use of quotas or other quantitative restrictions on imports except to safeguard the balance of payments—a provision which could scarcely be invoked by the United States without risk of putting pressure on the dollar in other ways. The same inhibition would arise with regard to the imposition of exchange restrictions on current transactions, for which the prior approval of the International Monetary Fund would be required under Article VIII of the Articles of Agreement.

³⁵ Duty rates were raised from 20 to 40 per cent on imports from the United States of polyethylene, polystyrene, and cloth of artificial fibers, from 21 to 40 per cent on cloth of synthetic fibers, and from 15 to 19 per cent on paints and varnishes. The United States, under Article XIX of GATT, had offered reductions on other commodities in compensation for the increase in duties on carpets and glass, but the Common Market countries, also invoking Article XIX, declared the offered compensation inadequate. See Department of Commerce, *International Commerce*, Washington, June 18, 1962, p. 48.

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Congress passed legislation which curtailed tax haven operations, but without affecting the basic deferral of taxation for operating companies in developed countries.

Efforts to increase receipts seem to have given the most tangible results so far, especially in the government sector. These have included advance repayments of debt to the United States Government, though this is an exhaustible resource,³⁶ and the agreement with Western Germany and those expected to be signed with other countries for the purchase of military equipment and services from the United States.³⁷

³⁶ From 1959 through the third quarter of 1962 prepayments of debt to the U.S. Government totaled close to \$1.7 billion, more than 80 per cent of which was by countries of the Common Market. These countries, which for the time being would seem to be the most likely source of further prepayment, now owe the United States about \$1.3 billion (exclusive of \$200 million which Germany wants to offset against war claims on the United States), France accounting for some three-fourths of this figure. The United Kingdom owes the U.S. Government more than \$4 billion, but would be a much less likely source of prepayments.

In retrospect, we may have learned too well the lesson of the debts from the First World War. Seen from the present vantage point in time, it might have proved useful if, on the aid extended after the Second World War, we had retained title to some of the counterpart funds in European currencies as contingent claims to be exercised, at our volition, in case of need. We could thereby have held large foreign exchange assets for currency stabilization operations and could also have provided from these funds the economic aid to the less developed countries which some European countries seem reluctant to extend, with indirect benefits to our own balance of payments. It may be noted in this connection that the total amount of grant aid extended by the United States after World War II (net of conversions to loans and of reverse grants and returns) came to \$10.7 billion for countries now comprising the Common Market and \$2.7 billion for the United Kingdom, not counting close to \$11 billion of military supplies and services (Department of Commerce, *Foreign Grants and Credits by the United States' Government*, December 1961 Quarter, July 1962).

³⁷ In his statement on July 16, 1962, the Secretary of Defense referred to the agreement with the Federal Republic of Germany as one "by which the United States provides a cooperative logistics system for the armed forces of both countries and the Federal Republic of Germany will increase the level of military procurement in the United States and utilize American supply lines, depots, and maintenance and support facilities to fully offset the foreign exchange costs of maintaining our forces in Germany for a 2-year period." Assistant Secretary Hitch, in his testimony on December 12, stressed the importance of the undertaking by Germany (recently extended, he said, to cover the period through calendar year 1964) to offset our defense expenditures in that country, noting that these expenditures currently amount to \$675-700 million a year. (This would not all be net gain, however, since Germany had previously been purchasing military items from the United States in smaller amounts.) Assistant Secretary Hitch further stated: "In addition, within the last few weeks, Italy has agreed to purchase over \$100 million of military equipment from the United States as a first step toward offsetting our foreign exchange costs in that country. We are negotiating similar arrangements

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The export drive, aimed at increasing the foreign exchange earnings of the private sector, has the great virtue of being addressed to the largest item in the balance of payments, so that even marginal results could be significant. In view of the time required for such an effort to arouse widespread interest and support, and the further time required for new business to be registered in actual deliveries, the program can scarcely have made much impact on the export figures so far, but, with the support of the newly expanded export credit insurance arrangements, it may become cumulatively effective.

Perhaps the most important change to the advantage of our exports since the adverse shift in the balance of payments has been the removal of the remaining quantitative import restrictions, in particular the discriminatory restrictions on goods from the dollar area, which other countries had imposed during the period of their own balance-of-payments difficulties. Most of these restrictions have now disappeared in Europe, with the notable exception of those on agricultural products, providing some visible benefits to our exports already and the opportunity to cultivate markets for goods which had previously been closely circumscribed. Japan has also made progress in liberalizing imports, but still maintains restrictions on a wide range of goods of significant trade interest.

At the same time, however, a new cause for concern arises because of the commercial policies of the members of the European Common Market. At an earlier stage, our attention was focused on the importance of creating a large European trading area with no internal barriers. Now, as the Common Market becomes more of a reality and attracts new adherents, we are increasingly concerned lest our ability to compete in it with our capital goods, our consumer manufactures, our industrial materials, and our foods be inhibited by its external tariffs and quotas. Even if we succeed in improving our

with other countries and contemplate approaching still others in the near future." He characterized the procurement of U.S. military equipment by our Allies as "the most promising method by which we can reduce the net adverse balance."

The balance-of-payments article in the December 1962 *Survey of Current Business* reports military receipts on two bases, Table 1 showing "military sales" of \$96 million in the first quarter, \$153 million in the second, and \$168 million in the third, and Table 2 showing "military cash receipts" of \$221 million in the first quarter, \$241 million in the second, and \$226 million in the third. The smaller figures are on a delivery basis, and the larger ones include, in addition, funds transferred to restricted accounts for military purchases to be made by foreign governments in the United States.

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relative position by using the increased scope for negotiations provided by the Trade Expansion Act of 1962, we can scarcely hope to avoid some new strains and adjustments as the Common Market comes into being. The outlook for some of our important agricultural exports is especially disturbing.

There is also ground for concern that the commercial policies of many European countries may accord insufficient recognition to the need for the advanced nations to increase their imports from the less developed, low-wage countries,⁸⁸ and that the adjustments in trade and production necessary to this end may continue to fall unequally on the United States. Table 13 testifies to the disparities now prevailing in this regard. It will be noted that the table covers a number of labor-intensive products in which the low wages of the newly industrializing countries might be expected to give them a competitive advantage as contrasted with industries requiring greater inputs of capital and skill.⁸⁹ Imports of these products in 1959-1960 from all sources by the United States and by the Common Market (EEC) and the EFTA countries (including trade within these groups) were of roughly similar orders of magnitude. The United States, despite various restrictive measures, took 58 per cent of its total from Japan and other Asian countries, whereas the EFTA group took only 22 per cent and the Common Market group a mere 6 per cent from these sources. The absolute amounts, which may provide the most relevant comparisons, show that imports of these manufactures from Asian sources by the United States averaged close to \$540 million per year, or almost two and a half times those of the EFTA countries and almost eight times those of the Common Market countries. Within the EFTA group, imports by the United Kingdom, with its special ties with some of the Asian

⁸⁸ These problems are examined in detail in Chapter V ("Europe and the Trade Needs of the Less Developed Countries") of United Nations Economic Commission for Europe, *Economic Survey of Europe in 1960*, Geneva, 1961.

⁸⁹ Japan, though now an industrialized nation, is included as a supplier in the table along with other Asian countries because its wages are still low compared with those in the United States and Western Europe, because the composition of its exports still shows many of the traits of a newly industrializing country, and because the United States and Western Europe would seem to share a political interest in developing trade with Japan rather than risk that it may become dependent on trade with Mainland China and other Communist countries or frustrated through inability, for lack of export outlets, to increase its imports sufficiently to support its economic growth.

TABLE 13

IMPORTS OF SELECTED MANUFACTURES BY THE UNITED STATES
AND BY MEMBERS OF THE EUROPEAN ECONOMIC COMMUNITY
AND OF THE EUROPEAN FREE TRADE AREA, TOTAL AND
FROM THE FAR EAST, 1959-1960, ANNUAL AVERAGE
(millions of dollars)

SITC ^a Number	Commodity	United States		European Economic Community ^b		European Free Trade Area ^c	
		Total	From Far East ^d	Total	From Far East ^d	Total	From Far East ^d
651.03	Cotton yarn and thread, gray	2.1	—	27.8	—	32.6	7.2
652.01	Cotton fabrics, gray	33.9	21.5	43.4	12.5	111.8	77.8
653.04	Jute fabrics	100.9	90.1	5.3	2.0	24.9	18.8
656	Textile manufactures n.o.s. ^e	23.0	10.8	53.0	9.0	45.0	16.7
665	Glassware	22.5	3.4	49.7	.2	35.8	.8
686	Pottery	60.6	38.0	28.4	3.2	20.7	2.2
841	Clothing, excluding fur	272.9	183.2	229.2	20.2	248.1	52.2
851	Footwear	117.7	70.7	63.7	2.7	75.4	11.2
861	Scientific, optical, controlling instruments	72.0	26.9	149.0	7.4	153.4	9.0
899	Manufactured articles n.o.s. ^e	218.7	94.1	481.3	12.4	248.8	24.7
	Total of items listed	924.3	538.7	1,130.7	69.6	996.4	220.4

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NOTES TO TABLE 13

^a Standard International Trade Classification of the United Nations. The numbers given are as in the original SITC before revisions which became effective with the publication of trade data for 1961.

^b Belgium-Luxembourg, France, Germany, Italy, and the Netherlands.

^c Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the United Kingdom. With the exception of the first two items (SITC Nos. 651.03 and 652.01), the import values included for Switzerland are for 1960 only, rather than the two-year average, because of the absence of detail for 1959 corresponding to the other SITC items listed.

^d China (including imports from Mainland China in the case of members of the European Economic Community and the European Free Trade Area), Hong Kong, India, Japan, Pakistan, Philippines, Thailand, and the Malay Federation.

^e Not otherwise specified in the SITC.

SOURCE: Organization for European Economic Cooperation, *Trade by Commodities*, Series C, Volume II, Imports, 1959 and 1960.

NOTE: The items selected are those given in the *Economic Survey of Europe in 1960*, United Nations, 1961, p. V-37.

countries, averaged \$171 million, the only figure remotely comparable with that for the United States. Western Germany's imports averaged \$35 million, accounting for one-half of the total for the Common Market, and France was at the foot of the list with an infinitesimal \$1 million of imports of manufactures from Asian sources.

These differences might be explained in part by a smaller labor-cost advantage in Asian countries compared with Western Europe than compared with the United States, and perhaps also in part by a concentration of Asian sales efforts in the United States market. But it is also true (and of course relevant to the second of these points) that Western European countries have typically applied severe restrictions against imports of manufactures from Japan and other Asian sources. These restrictive policies, which so far show little evidence of significant relaxation, provide some basis for fears which have been expressed that the new regional grouping in Western Europe may show little concern for the needs and interests of the less privileged parts of the world. Given the chronic labor shortages which threaten to impede growth and foster inflation in most Western European countries, it would seem to be sensible if they were to decide, in their own interest, to import more freely of labor-intensive goods and thereby release manpower to industries of greater productivity.

4. *The Comparative Performance of Exports and Imports*

It is scarcely possible, at least without much further study, to disentangle the various influences which have been discussed and to measure their separate effects on our international competitive position. We may, however, consider the changes which have actually occurred over the last decade in our total exports and imports of goods and non-military services as reflecting the combined impact of these and perhaps still other influences. It should also be useful to take a closer look at our performance in international trade in manufactured goods, since this is the area of major concern with respect to changes in our competitive position.

AN OVER-ALL VIEW: EXPORTS AND IMPORTS OF GOODS AND NON-MILITARY SERVICES

In examining the relative changes in United States exports and imports of goods and nonmilitary services, the first problem is that of choosing an appropriate base period. In the discussion of this question at the end of Chapter II it was noted that there would be some advantage in extending the base to include a fairly long period, such as the six years 1950-1955. It seemed preferable, however, to omit the years most affected by the Korean war and to limit the base accordingly to 1953-1955. A choice is facilitated by the fact that, as indicated by Chart 9, it makes little difference whether one or the other base is taken.

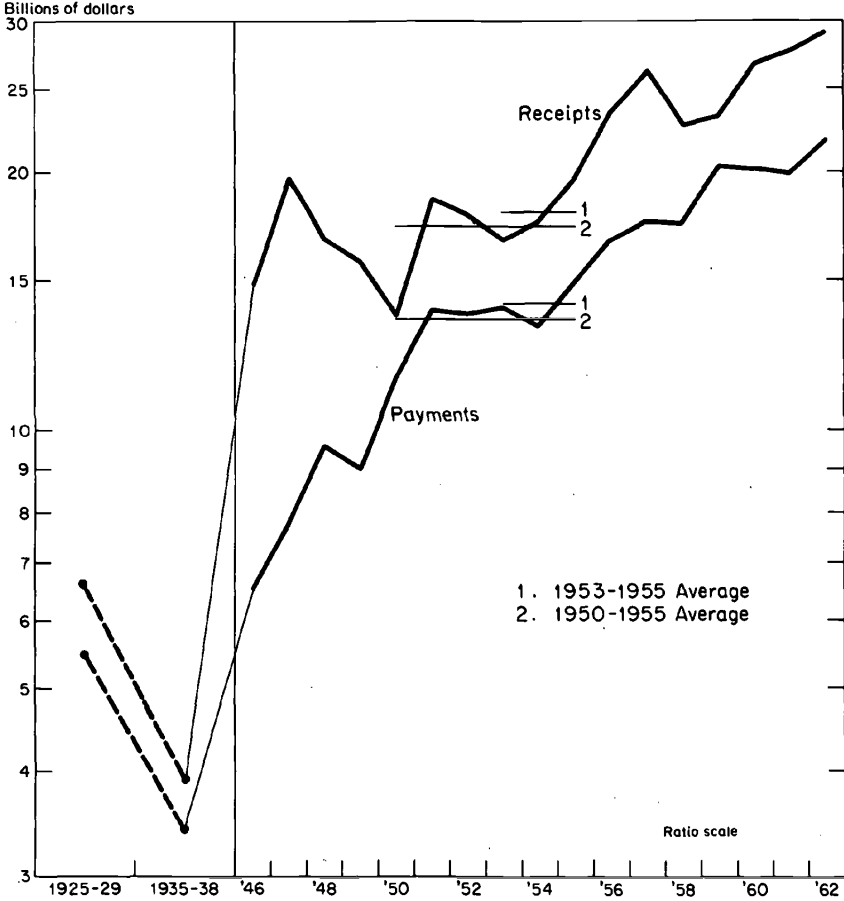
On the surface, at least, the results summarized in Tables 14 and 15 indicate the need for some qualification of the view that the United States has suffered a serious deterioration in its international competitive position in recent years. A certain strengthening of that position would even appear to be suggested by the appreciably faster increase in exports than in imports both on merchandise account alone and on goods plus nonmilitary services. The surplus on these items has consequently increased by more than \$3 billion—enough to offset the rise in the various other expenditures listed in Table 7, though still leaving the balance on basic transactions in deficit.

As far as these comparisons go, it would appear either that the forces tending to weaken the competitive position of the United States have been overstated or that they have been outweighed by other forces tending to strengthen it. Caution is, however, required with respect to the nature and permanence of some of these counterforces.

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CHART 9

**Payments and Receipts on Goods and Nonmilitary Services,
1925-1929 and 1935-1938, Annual Averages, and
1946 to 1962, Annually**



NOTE: 1962 data are for January-September, seasonally adjusted annual rate.

SOURCE: U.S. Department of Commerce.

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For one thing, as has been noted, part of the increase in United States exports is accounted for by goods supplied directly under government aid programs. Data are not available for all such goods in earlier years, but certainly the greater part, especially within the time period considered, is represented by exports of agricultural products under our surplus disposal programs. An adjustment for these shipments, as given in the memorandum items at the bottom of Tables 14 and 15, reduces the percentage increase in exports since 1953-1955 (not, however, in relation to 1950-1955) but still leaves a decided advantage for exports compared with imports.

A further qualification is, however, needed to allow for that part of our exports in 1960 and 1961 made possible by the credits which were extended by American banks and business concerns and which figured prominently in the large outflows of short-term funds in those years.⁴⁰ An allowance for this influence, though difficult to estimate closely, would probably still leave the increase in exports to 1960-1961 greater than that in imports.⁴¹ Credits by the United States serve to finance other countries' imports not only from this country but also from other sources, either directly in some cases or indirectly by releasing other funds available to the importing countries. Moreover, foreign borrowers are not without access to alternative sources of credit, including in particular the active Euro-dollar market operated by commercial banks in foreign financial centers and fed by the large official and unofficial dollar holdings accumulated abroad. Preliminary data for the first nine months of 1962, on the other hand, indicate that short-term credits played a much smaller role in financing exports during that period and, that accordingly, less qualification would be needed for this factor in the 1962 figures given in Tables 14 and 15.⁴²

⁴⁰ See Table 5 and also the discussion on p. 37.

⁴¹ For purposes of illustration, let it be assumed that 50 per cent of the reported short-term outflow in 1960 and 1961 as given in Table 5 (i.e., some \$700 million in each year) made possible exports from the United States that otherwise would not have been made. A deduction of these exports, in addition to the adjustment already made for agricultural exports under special government programs, would reduce the increase in merchandise exports from 1953-1955 to 1960-1961 to 42 per cent (compared with 33.4 per cent for merchandise imports) and that for exports, including nonmilitary services, to 45.5 per cent (compared with 42.8 per cent for corresponding imports).

⁴² Information is not yet available to permit an adjustment for agricultural exports under special government programs in 1962.

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TABLE 14

PAYMENTS AND RECEIPTS ON GOODS AND NONMILITARY SERVICES
AND BALANCE ON BASIC TRANSACTIONS, BY SELECTED PERIODS, 1950 TO 1962
(millions of dollars, annual averages or annual rates)

	1950- 1955	1953- 1955	1960- 1961	1962 Jan.- Sept. ^a
<i>Payments</i>				
Merchandise imports	10,670	10,957	14,618	16,109
Travel expenditures abroad	907	1,030	1,746	5,748
Other nonmilitary services	1,939	2,056	3,694	
Total, goods and nonmilitary services	13,516	14,043	20,058	21,857
<i>Receipts</i>				
Merchandise exports	12,820	13,120	19,687	20,772
Income on investments	1,981	2,194	3,452	4,035
Other nonmilitary services	2,516	2,665	4,030	4,363
Total, goods and nonmilitary services	17,317	17,979	27,169	29,170
<i>Net receipts on goods and nonmilitary services</i>	3,801	3,936	7,111	7,313
<i>Net payments (—) on government transactions, private long-term investment, and remittances and pensions (from Table 7)^b</i>	—5,613	—5,644	—8,669	—8,615
<i>Balance on basic transactions^b</i>	—1,812	—1,708	—1,558	—1,302
<i>Memorandum items</i>				
Agricultural exports under special government programs ^c	1,013	822	1,519	n.a.
Receipts adjusted to exclude agricultural exports under special government programs				
Merchandise exports	11,807	12,298	18,168	n.a.
Total, goods and nonmilitary services	16,304	17,157	25,669	n.a.

NOTES TO TABLE 14

NOTE: The adjustment made in the memorandum items do not entail a similar adjustment of the balance on basic transactions, since the transfer of these agricultural products is entered on both sides of the accounts (i.e., as a receipt for exports and as a payment under government grants and credits).

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NOTES TO TABLE 14 (continued)

^a Seasonally adjusted; preliminary data.

^b Excludes unscheduled debt repayments to the U.S. Government (see Tables 1 and A-4).

^c The exports excluded are those supplied under various government aid programs (such as the European Recovery Program, Mutual Security Program, etc.); U.S. Department of Agriculture donations and barter deals, starting in 1950; and Public Law 480 for the disposal of surplus farm products, starting in 1954. The figures do not include "shipments of some commodities with governmental assistance in the form of (1) extension of credit for relatively short periods, sales of government-owned commodities at less than domestic market prices, and (2) export payments in cash or in kind." (See U.S. Department of Agriculture, Economic Research Service Report No. 84, June 1961, and other reports in the same series.)

The amount excluded for 1950-1955 is the average for the seven-year period July 1949 - June 1956, and the amount excluded for 1953-1955 is the average for the four-year period July 1952 - June 1956, data not being available for these years on a calendar-year basis.

SOURCE: U.S. Department of Commerce.

COMPETITIVE POSITION IN TRADE IN MANUFACTURES

The relatively favorable performance of our exports compared with that of our imports of goods and nonmilitary services is not necessarily inconsistent with a much more pessimistic hypothesis about our position in international competition, especially with regard to trade in manufactured products. To bring together various doubts that have been expressed in this regard, this hypothesis might be formulated as follows: that costs and prices in the United States are out of line with those of its leading competitors; that market imperfections, however, retard shifts in trade in response to these disparities; that, for the time being, the more rapid increase in incomes in other industrial countries than in the United States has tended to keep our exports rising in relation to our imports; that, for these reasons, the United States may have benefited so far from its higher prices through gains in the terms of trade more than it has lost through the impairment of its competitive position;⁴³ that, however, the erosive effects of our unfavorable price

⁴³ In other words, the suggestion is that, under the conditions specified, foreign demand for United States exports has been relatively inelastic in the short run, and that total export proceeds have been greater than they would have been had export prices not risen in relation to import prices. However, if foreign demand has, in fact, been relatively elastic, a lower level of export prices would have served to increase the quantity of exports enough to yield a greater total return than that actually realized.

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TABLE 15

**PERCENTAGE INCREASE IN PAYMENTS AND RECEIPTS ON GOODS AND
NONMILITARY SERVICES**

	<i>Measured from</i> 1950-1955		<i>Measured from</i> 1953-1955	
	1960- 1961	1962 Jan.- Sept.	1960- 1961	1962 Jan.- Sept.
<i>Payments</i>				
Merchandise imports	37.0	51.0	33.4	47.0
Travel expenditures abroad	92.5	102.0	69.5	86.3
Other nonmilitary services	90.5		79.7	
Total, goods and nonmilitary services	48.4	61.7	42.8	55.6
<i>Receipts</i>				
Merchandise exports	53.6	62.0	50.1	58.3
Income on investments	74.3	103.7	57.3	83.9
Other nonmilitary services	60.2	73.4	51.2	63.7
Total, goods and nonmilitary services	56.9	68.4	51.1	62.2
<i>Memorandum items (receipts adusted to exclude agricultural exports under special government programs)</i>				
Merchandise exports	53.9	n.a.	47.7	n.a.
Total, goods and nonmilitary services	57.4	n.a.	49.6	n.a.

SOURCE: Table 14.

position will be increasingly felt and may be accentuated to the extent that the United States succeeds in raising its level of employment and its rate of growth in relation to those of other industrial countries.

That part of this formulation concerning market imperfections was developed with great cogency by Yntema in a statement published at the beginning of 1960:

... On the basis of fragmentary evidence, it seems to me that our exchange rates are incompatible with the fundamental relation between costs of production here and abroad. The effects on our balance of payments resulting from the disparities in costs here and abroad are limited now by market imperfections—by

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lack of knowledge, inadequate procurement arrangements abroad by U.S. purchasers and inadequate distribution systems here for foreign producers. In the future the effects of these disparities in costs will be felt increasingly as foreign capacities expand, as economies of scale in production and distribution of foreign products increase, as more U.S. know-how is exported, as U.S. procurement abroad becomes more efficient (and more extensive) and as distribution systems for foreign products in the U.S. improve.⁴⁴

Yntema's statement was drafted in the shadow of the extremely adverse trade and payments developments of 1958 and 1959 depicted in Chapter II and loses something in force by virtue of the subsequent recovery of 28 per cent in merchandise exports as against a rise of 5 per cent in imports (from 1959 to the first nine months of 1962, annual rate). The view expressed may nevertheless correctly characterize certain important elements in our foreign trade position. The growth of our imports of manufactures suggests that the frictions to which Yntema alluded are being overcome, and that further penetration of the American market by some of these and perhaps still other products can be expected.⁴⁵ Though his statement seems to refer only to imports, similar forces are no doubt working to displace some of our exports. The question, however, is how extensive and pervasive are these forces? Are they dominant, or are they offset by other forces? And are the disturbances persistent and continuing, or do they tend to stimulate corrective reactions?

It is a mark of the inadequacy of our factual knowledge and analytical capacities that answers to questions such as these remain so largely subject to conjecture and contention. In this connection, note may be taken of one set of data widely cited as evidence of a strongly unfavorable trend in the competitive power of the United States—that is, the progressive decline in its share of total world exports of

⁴⁴ From a footnote of dissent by Theodore O. Yntema in a Committee for Economic Development brochure, *National Objectives and the Balance of Payments Problem*, New York, 1960, pp. 3-4.

⁴⁵ It is understood that some American companies have found it cheaper, for like qualities, to procure various items of materials and equipment abroad for their foreign operations, but nevertheless continue to patronize their traditional domestic suppliers for their requirements in this country. Such private "Buy American" policies could, however, give way in time, if price differentials persist. On the other hand, it would seem plausible to suppose that similar market imperfections abroad (including those created by the formerly severe restrictions against imports of nonessentials from this country) may handicap our own exports and could be made to yield to an energetic export drive.

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manufactures from 27 per cent in 1950 to about 25 per cent in the mid-50's and 20 or 21 per cent at present. By this standard, the United States has indeed lost in competitive position. But one must be clear about what the standard measures. It reflects, as a major component of the decline, the fact that some countries, especially Western Germany and Japan, still had an abnormally low share in world production and trade at the beginning of the 1950's. The subsequent rapid increase in their production and imports had to be accompanied by a rapid increase also in their exports—in fact, an even more rapid increase in exports than in imports unless they were to continue to receive financial assistance from the United States or elsewhere. No figures on market shares drawn from the past, whether the early postwar years or some prior period, are necessarily appropriate to our circumstances of today, but the data presented in Chart 10 put the matter in longer historical perspective. In relation to any of the years shown prior to World War II, it is not the United States but rather the United Kingdom that has lost ground in world trade in manufactures and made way, so to speak, for the gains of others, not only Western Germany and Japan but also the smaller industrial countries.⁴⁶

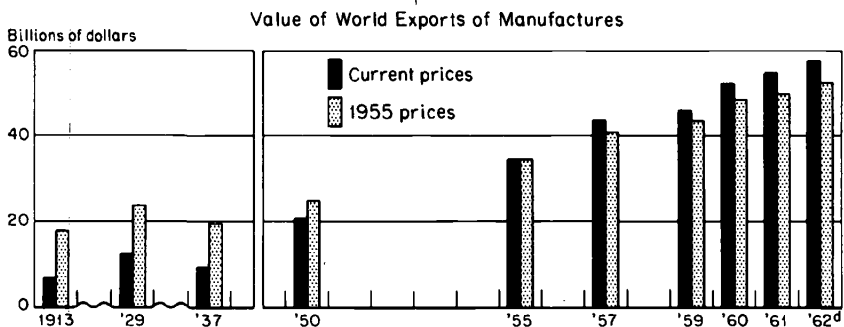
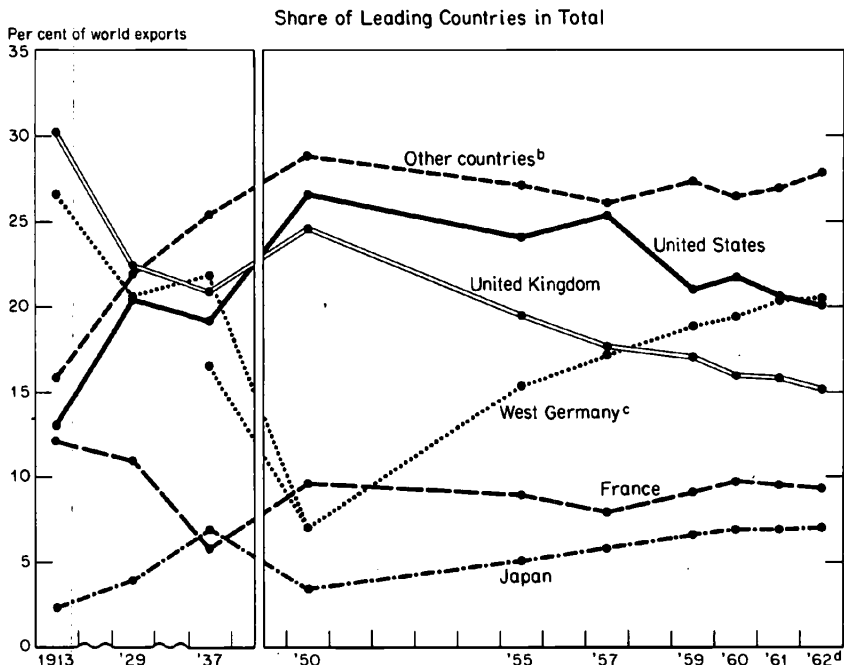
It is true, however, that the decline in the United States share in world exports of manufactures in the last few years includes another component reflecting the important fact that its exports have not risen enough, or its imports too much, to meet the increase in its international financial load and at the same time close the gap in its international payments. To relate the figures on market shares to the problem at hand, one may say that—if the whole of the deficit on basic transactions in the first nine months of 1962 were to have been eliminated exclusively by changes in our trade in manufactures—the share of the United States in world exports of these goods (totaling some \$57 billion, annual rate) would have needed to be higher by about 2 to 2.5 percentage points, achieved either by larger exports of its own or by smaller imports of other countries' exports of manufactures. It is this figure, suggesting sufficient problems in itself, rather than the 6 or 7 percentage-point decline since 1950 that gives some indication of the strengthening needed in our competitive position in

⁴⁶ On the basis of recent trends, however, the National Institute of Economic and Social Research (London) suggests that "the downward trend in Britain's share in world trade in manufactures may at last have been halted" (*Economic Review*, November 1962, pp. 10, 11).

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CHART 10

World Exports of Manufactured Goods, Selected Years, 1913 to 1962



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NOTES TO CHART 10

^a Commodity composition corresponds to Sections 5 to 8 of the United Nations' Standard International Trade Classification. Exports from countries of the Soviet bloc are not included.

^b Belgium-Luxembourg, Canada, India, Italy, Netherlands, Sweden, and Switzerland, except that the Netherlands is not included in 1913 and India is not included in 1960 and subsequently.

^c The lower point shown for 1937 is based on the estimated share of the area now comprising the Federal Republic in total German exports of manufactures in 1937. The higher point for 1937 and also the points for 1913 and 1929 relate to the whole of Germany as of each of those years.

^d Data for first six months, seasonally adjusted. The unadjusted figures are: U.S., 20.7; West Germany, 19.9; U.K., 15.6; France, 9.5; Japan, 6.8; other countries, 27.5.

SOURCE: (1) For years 1913-1959: Forthcoming study on *Industrialization and International Trade* by Alfred Maizels, London, National Institute of Economic and Social Research, except as noted in 3. (2) For years 1960-1962: *Economic Review*, London, National Institute of Economic and Social Research, November 1962, p. 59, except as noted in 3. (3) Value of world trade at 1955 prices in 1960, 1961, and 1962 computed from price index for world exports of manufactured goods given in *Monthly Bulletin of Statistics*, United Nations, June 1962, p. viii. Value of world trade at 1955 prices in 1913 is derived from a series in Maizels' study computed in 1913 prices.

manufactures for purposes of bolstering the balance of payments.

Something of the nature of the problem facing the United States in strengthening its competitive position in manufactures is indicated by the relative course of its exports and imports of these products over the past decade. The series given in the first part of Chart 11 show that the absolute rise in exports of manufactures, including semi-manufactures,⁴⁷ has been greater than that in imports. The rise in the excess of exports over imports is, however, small—a gain of about \$1.3 billion in the annual averages for the period 1960 through the first three quarters of 1962 over the averages for 1953-1955. For finished manufactures only, the gain was little more than \$400 million. It is also evident from the same series plotted on a ratio scale in the second part of the chart that, in percentage terms, the rate of increase in imports of manufactures, especially of finished manufactures, has been

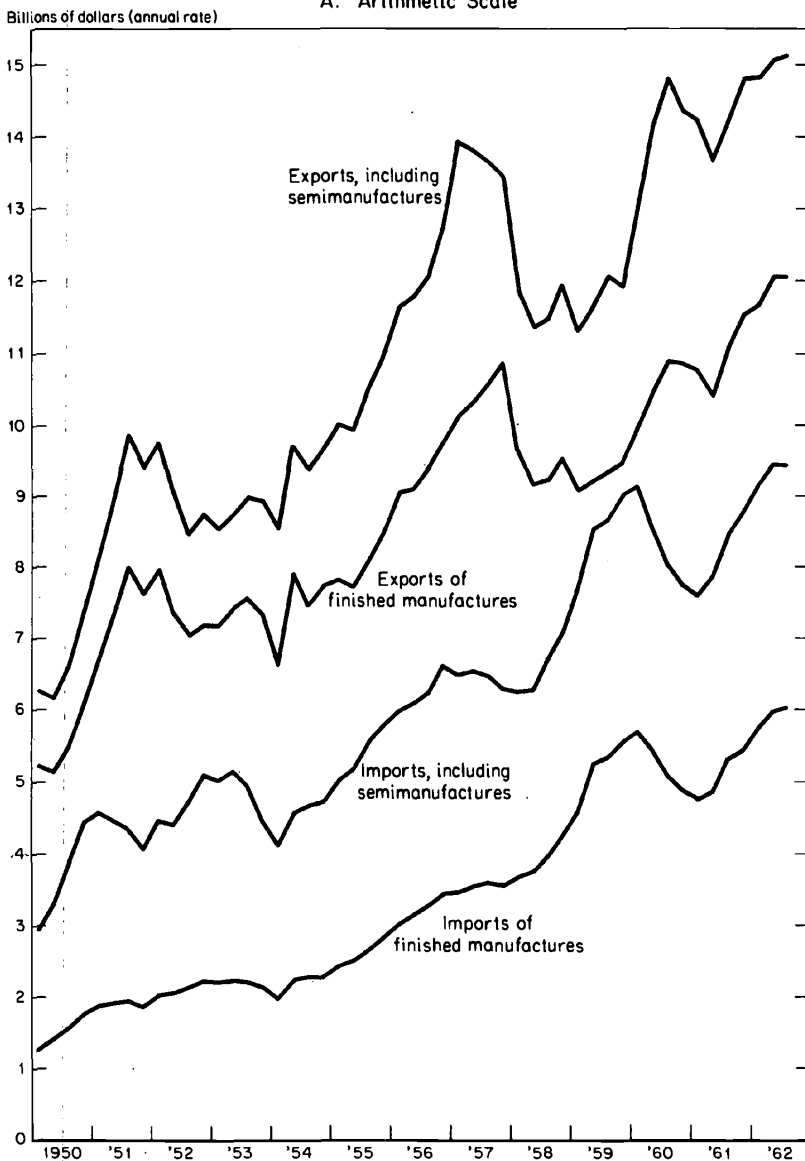
⁴⁷ The groupings given in Chart 11 are from the arrangement by "economic classes" of the Department of Commerce. The series for finished manufactures is somewhat narrower, but that including semimanufactures somewhat broader, than the definition of manufactures in Chart 10, which is derived from the Standard International Trade Classification developed by the United Nations.

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CHART 11

U.S. Trade in Finished Manufactures and Semimanufactures

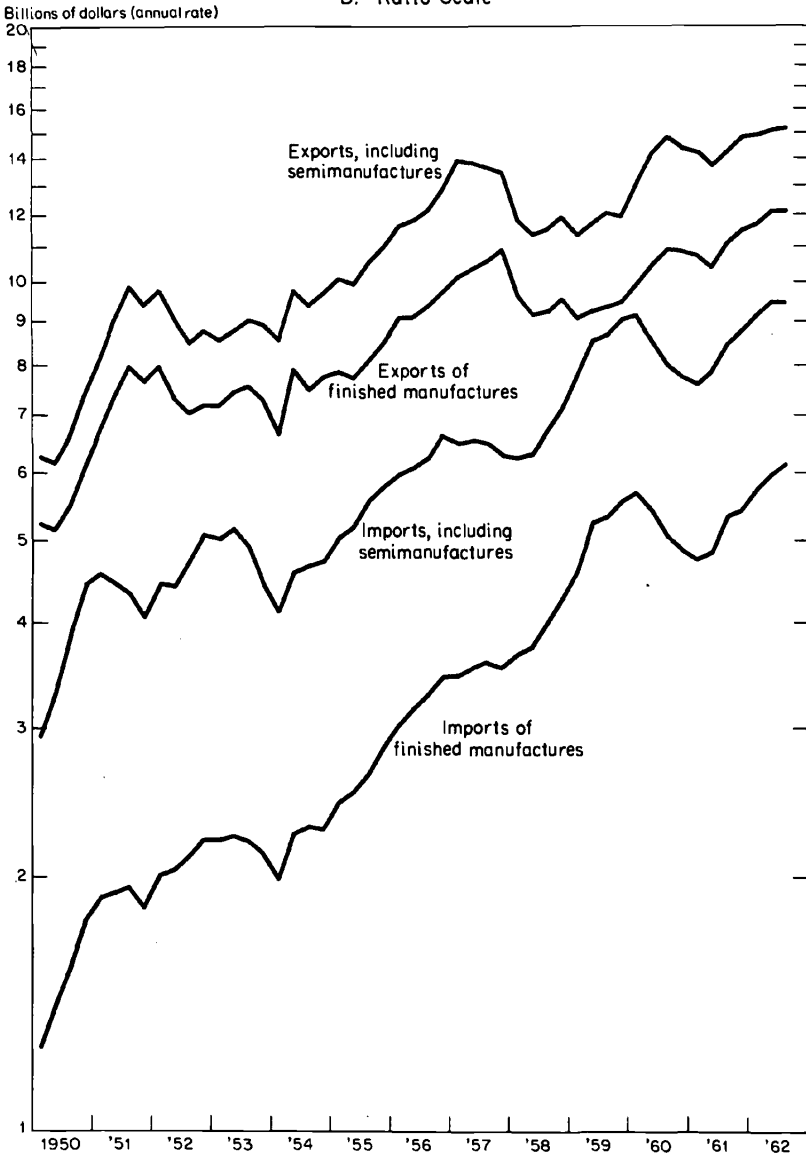
A. Arithmetic Scale



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CHART 11 (concluded)

B. Ratio Scale



NOTE: Data are seasonally adjusted.

SOURCE: U.S. Department of Commerce.

TABLE 16

UNITED STATES FOREIGN TRADE IN RESEARCH-INTENSIVE PRODUCTS^a
(millions of dollars, annual averages or annual rates)

	1926- 1935	1953- 1955	1956- 1957	1958- 1959	1960- 1961	1962 Jan.- Sept. ^b	1960- 1961	1962 Jan.- Sept. ^b
I-A. U.S. exports, including special category Type IIc								
Total exports, all products	3,338	14,307	19,300	17,067	20,163	21,046	41	47
Exports of research-intensive products (percentage of total)	780 (23.4)	6,508 (45.5)	8,438 (43.7)	8,056 (47.2)	9,417 (46.7)	10,533 (50.0)	45	62
Construction, excavating, and mining machinery	40	492	845	695	768	838	56	70
Other industrial machinery	110	1,054	1,482	1,545	1,861	2,192	77	108
Electrical apparatus	83	869	1,023	1,003	1,072	1,245	23	43
Office machines and parts	33	93	122	139	260	331	180	256
Scientific and professional instruments	8	63	97	99	118	144	87	129
Photographic and projection goods	20	80	102	109	137	153	71	91
Agricultural implements	31	129	130	134	144	166	12	29
Tractors, parts and accessories	37	332	385	333	373	372	12	12
Automobiles, parts and accessories	277	1,347	1,499	1,281	1,240	1,292	-8	-4
Aircraft, parts and accessories	8	745	1,047	878	1,282	1,499	72	101
Railway transportation equipment	13	110	127	157	150	162	36	47
Synthetic fibers and manufactures	5	223	248	250	307	326	38	46
Medicinal and pharmaceutical preparations	16	229	265	281	275	269	20	17
Chemicals and related products ^d	99	742	1,066	1,152	1,430	1,544	93	108

(continued)

TABLE 16 (concluded)

	Percentage Increase from 1953-1955 to						
	1926- 1935	1953- 1955	1956- 1957	1958- 1959	1960- 1961	1960- 1961	1962 Jan.- Sept. ^b
I-B. U.S. exports, excluding special category Type II							
<i>Total exports, all products</i>	3,338	12,623	17,847	15,753	18,782	19,180	52
Exports of research-intensive products ^a (percentage of total)	780 (23.4)	5,379 (42.6)	7,198 (40.3)	6,988 (44.4)	8,269 (44.0)	8,906 (46.4)	66
Electrical apparatus	83	635	786	807	842	894	41
Automobiles, parts and accessories	277	1,081	1,334	1,116	1,170	1,177	9
Aircraft and aircraft engines	8	131	225	188	451	361	176
Chemicals and related products	99	727	1,050	1,135	1,413	1,521	109
II. U.S. imports							
<i>Total imports, all products</i>	2,868	10,821	12,949	14,310	14,821	16,044	48
Imports of research-intensive products (percentage of total)	138 (4.8)	684 (6.3)	1,075 (8.3)	1,784 (12.5)	1,885 (12.7)	2,168 (13.5)	217
Industrial machinery	n.a.	107	145	152	228	283	164
Electrical apparatus	15	48	122	206	293	394	721
Office machines and parts	n.a.	10	30	42	83	80	700
Scientific and professional instruments	2	15	26	33	44	52	247
Photographic goods	4	23	37	46	58	71	209
Agricultural implements and parts	5	76	78	146	124	152	100
Automobiles and parts	2	64	241	699	503	489	664
Aircraft and parts	—	30	70	73	107	134	347
Synthetic fibers and manufactures	9	45	51	72	73	100	122
Chemicals and related products	101	266	275	315	372	413	55

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NOTES TO TABLE 16

^a The selection of "research-intensive" goods is that given for U.S. exports by Erik Hoffmeyer, *Dollar Shortage and the Structure of U.S. Foreign Trade*, Copenhagen and Amsterdam, 1958, pp. 189-190.

^b Not seasonally adjusted.

^c "Special category" goods of Type II are selected items for which, under national security restrictions, details are published by commodity but not by country. "Special category" goods of Type I are those for which only totals are published, without distribution by commodity or by country, and are not included above. A list of the items in these groups is given in report FT 410 for January 1961, issued by the Bureau of the Census.

^d Excluding medicinal and pharmaceutical preparations.

^e Product groups shown are limited to those affected by the exclusion of "special category" items. Others remain as in part I-A of the table.

SOURCE: Arranged from trade statistics published by the Department of Commerce.

much greater than that in exports. A continuation of these percentage increases would, of course, eventually make the absolute gain in imports exceed that in exports, but the rather uncertain course taken by both series in the last four or five years warns against any such simple projection.

Much the same observations can be made if we examine, in the light of Table 16, the development of United States trade in "research-intensive" goods, taking for this purpose the groups selected by Hoffmeyer.⁴⁸ Before World War II, imports of these goods made up only a small part of total imports and consisted chiefly of chemicals. In recent years, they have increased rapidly, trebling from 1953-1955 to 1962, and now include a wider range of goods. Exports of research-intensive products, though rising only 60 per cent during this time, still exceeded imports by \$6.7 billion in 1962 (January-September,

⁴⁸ See discussion on p. 53. As noted there, one may question whether competitive strength in these goods is mainly attributable to the amount of research incorporated in them or to other factors, such as size and growth of markets, conditioning the development of large-scale industry. However that may be, it is still of interest to observe the growth of United States exports and imports of these technologically advanced products.

It may be noted that Hoffmeyer applied his research-intensive criterion only to exports—an indication of the relatively small role which these products played in United States imports through the period (ending in 1955) covered by his study. In Table 16, however, his selection of items is applied also to imports (though presented in slightly more summary form than exports in the table).

Elements of Strength and Weakness

annual rate), or \$2 billion more than in 1953-1955.⁴⁹

Both imports and exports of research-intensive goods seem to show a certain retardation in the last few years. That in imports, it will be noted, is largely due to the fall in automobiles after the 1959 peak, an experience which suggests that the resistance of domestic producers tends to stiffen as the share of the market taken by imports increases. A number of other items in the import list may, however, have some distance to go before this point is reached.

The geographic distribution given in Chart 12⁵⁰ suggests that the slowing down in United States exports of research-intensive goods is largely attributable to the weakness in these exports to Canada and Latin America since 1956 and 1957, when investment in resource development reached a peak and created heavy demands for construction and mining machinery and other capital equipment. Exports to industrial countries, on the other hand, have continued to increase strongly and almost trebled from 1952 to 1960, though the upsurge in the latter year was influenced by the concentration of deliveries of jet aircraft. With a sustained, though much slower, rise in exports to still other countries, markets outside the Western Hemisphere now take more than half of total United States exports of research-intensive goods compared with about 40 per cent ten years ago.

Apart from such favorable or unfavorable implications as may be read from the statistical record, the analysis given in this chapter suggests various reasons for thinking that the increase in imports of manufactures may become less spectacular in relation to the rise in exports, and that the United States has a good possibility of continuing to

⁴⁹ These figures exclude exports in special category Type II. Inclusive of these exports, the excess of exports rose from \$5.9 billion in 1953-1955 to \$8.4 billion in 1962 (January-September, annual rate).

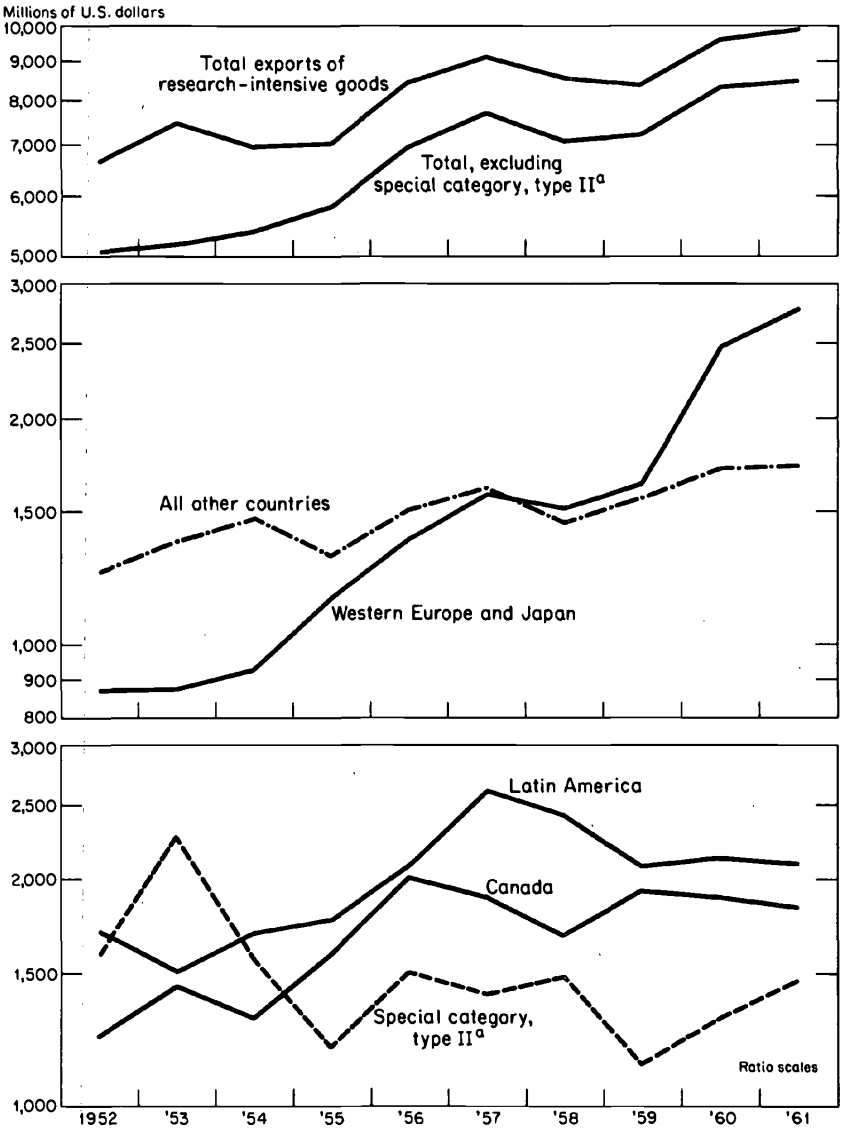
In a special study of U.S. exports, the *Survey of Current Business* for December 1962 finds a striking trend toward increased sales of highly specialized industrial equipment since 1959. Increased foreign demand for technologically advanced and custom-made types of equipment, the article states, is illustrated by the dramatic gains scored in recent years by such exports as paper and packaging machinery, plastic-making machinery, seamless-hosiery machinery, a variety of machine tools, electronic computers, measuring and testing instruments, and research laboratory apparatus. The article also notes, however, a growing tendency for domestic manufacturers to supply foreign demand from assembly plants and other manufacturing facilities abroad rather than from the United States.

⁵⁰ Exports of "special category—Type II" are plotted separately, since they are not available in country detail.

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CHART 12

U.S. Exports of Research-Intensive Goods by Destination, 1952-1961



^a Distribution by destination not available.

NOTE: See Table 16 for items included in research-intensive goods.

SOURCE: U.S. Department of Commerce.

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increase its export surplus in this major area of competition. These reasons include the fact that our exports of technologically advanced goods are still more broadly based than our imports, so that we may experience adverse shifts in our trade in various items and still gain on balance; the pressures on producers affected by increased imports or loss of exports to make a competitive response, including the search for ways of reducing costs and improving products; the tendency for wages and other costs to rise in Europe under conditions of high utilization of plant and manpower capacity; and the efforts made by the Government to promote exports which are probably only now beginning to bear fruit but may do so increasingly henceforth.

5. Growth and the Balance of Payments

As long as other leading industrial countries continue to operate at high levels of capacity utilization,⁵¹ increases in their exports may be difficult to achieve without increases in their imports or further upward pressures on their costs.⁵² These are, incidentally, reasons why

⁵¹ If, under these conditions, their rate of growth slows down for lack of manpower, some types of imports would presumably grow more slowly or even decline, but not necessarily imports of labor-saving machinery and materials.

A prospective leveling out of United States exports of machinery may be indicated by the recent behavior of the McGraw-Hill index of export orders for nonelectrical machinery, the only comprehensive series of its nature with respect to the range of products covered. The index (1957=100) fell from 177 in July 1962 to 154 in August and September, below the level of a year earlier. A recovery to 175 in October, however, brought the average for the four months to 165 compared with 166 for the first six months of the year and 161 for the first and second halves of 1961. On the other hand, the index is still at a very high level compared with the average of 121 for the whole of 1960. For a discussion of the McGraw-Hill export order index and related series, see the 1962 Annual Report of the National Bureau of Economic Research, pp. 96-98.

⁵² In this connection, it may be noted that the total merchandise imports of the Common Market countries increased 11 per cent compared with a rise of 6 per cent in their total merchandise exports in the first nine month of 1962 in relation to the same period of 1961. The absolute figures are as follows (annual rates, not seasonally adjusted):

	<i>Imports, c.i.f.</i>	<i>Exports, c.i.f.</i>
	(billions of dollars)	
1961 (January-September)	31.5	31.6
1962 (January-September)	35.0	33.4

SOURCE: International Monetary Fund, *International Financial Statistics*, October 1962, pp. 38, 39; December 1962, pp. 38, 39.

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the effects of the Common Market on United States exports, at least of manufactures, may be less severe than could be supposed from the difference in tariff treatment accorded imports from outside compared with trade among the members: to the extent that their trade with each other grows still faster than it would in the absence of preferential treatment, they will need either to slacken the growth of their exports to outside countries or to accelerate their imports from them.

A reduction in the disparity between American and European employment levels and growth rates caused by a slack in Europe would undoubtedly affect United States trade adversely, possibly offset in some measure, as far as the balance of payments is concerned, by changes in the flow of investment funds. Impressions of the vulnerability of the United States to such a situation may, however, have been exaggerated by the 1958 experience, when various attendant circumstances greatly accentuated the fall in United States exports.⁵³

A higher level of employment and faster rate of growth in the United States, activity in Europe continuing on more or less the present upward course, would also tend to affect the trade balance adversely, this time through increases in United States imports, possibly offset in its balance-of-payments effects by the enhanced attraction of investing in this country compared with Europe. Such a strengthening of the American economy should also, however, have some stimulating effect on third countries, notably our major trading partners in the Western Hemisphere. It should thus react favorably on our own exports, particularly since the supply position in the United States is so much easier than in other industrial countries and should allow room, at present, for increases in both domestic and foreign sales.

Perhaps the most important question relevant to the future development of our international position is whether we will be able to succeed in maintaining stability of the general price level under conditions of higher employment and more rapid growth. It may be that the relative improvement in our cost and price position vis-à-vis Europe over the past three or four years is no more than can be explained by the unsatisfactory levels of employment and corporate profits in the United States during this time.

⁵³ See pp. 30-32 above.