

88th Congress }
1st Session }

JOINT COMMITTEE PRINT

THE UNITED STATES BALANCE OF
PAYMENTS—PERSPECTIVES AND POLICIES

STAFF MATERIALS AND OTHER SUBMISSIONS
PREPARED FOR THE USE OF THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES



Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1967

24-974

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LETTER OF TRANSMITTAL

NOVEMBER 12, 1963.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the Joint Economic Committee and other Members of Congress is a collection of five statements concerning various aspects of the U.S. balance of payments.

The first was prepared by the committee's international economist, Dr. Gerald A. Pollack. It outlines the U.S. international payments and financial position, the policies of the United States and other nations affecting the U.S. balance of payments, and certain proposals for reforming the international monetary system.

The second was prepared by the program coordination staff of the Agency for International Development. This paper relates the balance-of-payments impact of aid to the function that aid serves in our foreign policy. It assesses the magnitude of that impact in relation to aid expenditures, and discusses policies that have been adopted to reduce the unfavorable balance-of-payments effects of aid.

The third, contributed by the Department of Defense, relates the U.S. balance-of-payments costs on military account to our overall strategic objectives and requirements. It explains why, with Europe enjoying new heights of prosperity, we continue to maintain large forces there. It also discusses the relative contributions of the United States and its allies to the common defense effort, and details new developments in the Defense Department's program to reduce the adverse effect on the balance of payments of its overseas program.

The fourth statement, by Dr. A. B. Hersey, of the Board of Governors of the Federal Reserve System, discusses the behavior of American imports and exports, and changes in capital movement during business cycles here and abroad.

The fifth statement, by Dr. Jack C. Rothwell, of the Federal Reserve Bank of Philadelphia, examines the impact of economic growth on the balance of payments.

The collection includes also as an appendix a compilation by the Department of State of quantitative restrictions maintained on imports by certain foreign countries. I have been advised by the Department of State that some of the quantitative restrictions maintained by Austria, Belgium, Luxembourg, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, and the United Kingdom may not be compatible with the obligations of these countries under the General Agreement on Tariffs and Trade.

The views expressed in this collection of statements are the contributors' and not necessarily those of the Joint Economic Committee or its individual members.

Faithfully,

PAUL H. DOUGLAS, *Chairman.*

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PART I
PERSPECTIVES ON THE UNITED STATES
INTERNATIONAL FINANCIAL POSITION

By
GERALD A. POLLACK, International Economist,
Joint Economic Committee

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PERSPECTIVES ON THE UNITED STATES INTERNATIONAL FINANCIAL POSITION

GERALD A. POLLACK, INTERNATIONAL ECONOMIST, JOINT ECONOMIC
COMMITTEE

I. THE MEANING OF THE BALANCE-OF-PAYMENTS DEFICIT

The U.S. balance of payments has been in deficit every year since 1949, except 1957. The deficits were welcomed in the early postwar years because they helped the rest of the world to rebuild reserves that had been depleted by the distortions of war and the needs of reconstruction. It became apparent after 1958, however, that U.S. deficits were adding dollars to the reserves of other countries at a rate faster than those countries desired. The persistence of U.S. balance-of-payments deficits has, in recent years, caused widespread concern regarding the future international role and stability of the dollar, and the future of the international monetary system. Before considering the elements contributing to this deficit, it is well to begin by examining precisely what is meant by the U.S. balance-of-payments deficit.

The deficit, under the official U.S. definition, measures the reduction in U.S. monetary reserve assets (chiefly gold) and the increase in liquid liabilities. Stated another way, it measures the decline, during the period covered, in the U.S. ability to defend the exchange value of the dollar with liquid resources owned by or automatically available to the monetary authorities.¹ This definition is heavily qualified with respect to the liquid resources it takes into account. But a less qualified definition of the deficit would not be measurable with statistical means, no matter how refined the available data. We would, of course, like to know the overall capacity, or change in overall capacity, of the United States to defend the value of the dollar. Yet the means available for this defense include not only the U.S. gold stock, U.S. holdings of foreign currency, and U.S. automatic drawing rights at the IMF, all of which are measurable, but also the U.S. capacity to borrow abroad which, though large, is not measurable. Moreover, this ability will presumably vary with the circumstances of the United States and of the creditor countries at the time credit is sought.

The definition does not take into account liquid international assets owned by American residents which, though measurable, are not controlled by the monetary authorities in the absence of extraordinary legislation. A U.S. resident contributes to the reported deficit if he draws down his balance in an American bank to open a demand deposit abroad. The increased dollar holdings of the foreign bank are an indirect claim against the U.S. monetary authorities, while the corresponding increase in privately owned liquid claims on

¹ For a comprehensive discussion of the definition and measurement of the deficit, see Walther Lederer, "The Balance on Foreign Transactions: Problems of Definition and Measurement" (Princeton University, International Finance Section Special Papers in International Economics No. 5, September 1963.)

foreigners is not directly within their reach. The recorded deficit is thus a limited measure, which focuses generally on the relationship between certain conventionally defined short-term assets and liabilities, and, in these terms, measures the deterioration in the U.S. liquidity position from year to year.

The present measure of the deficit counts as equally significant the loss of a dollar of U.S. gold reserves and a dollar increase in liquid liabilities to foreigners. From a number of viewpoints, however, the loss of gold is more serious than an equal increase in liquid liabilities. As a simple matter of arithmetic, U.S. gold reserves decline more as a percentage of U.S. liquid liabilities to foreigners when the deficit is financed through gold sales than when it is financed through increased dollar holdings by foreigners. Moreover, the implications for the defense of the dollar of increases in liquid liabilities to foreigners vary substantially according to the countries acquiring the liquid dollar holdings. Canada and Japan, for example, tend to hold their international reserves largely in U.S. dollars, while the British monetary authorities, who also manage a reserve currency, tend to convert almost all of their dollar acquisitions into gold. The seriousness to the U.S. monetary authorities of a given volume of outstanding liquid liabilities relative to the U.S. gold stock thus depends on the identity of the countries in which such holdings are concentrated.

The distinction between liquid and nonliquid claims and liabilities, which is a necessary aspect of the official measure of the payments deficit, must be arbitrary, for liquidity is not a matter of absolutes, but of degree along a continuous spectrum. The problem of distinguishing usefully between short- and long-term assets and liabilities is, of course, inherent in the preparation of all statements indicating financial condition, and arises in a number of other applications including the definition of the money supply. In measuring the balance-of-payments deficit, not all changes in short-term assets and liabilities are included. Changes in the amount of U.S. currency held abroad cannot be determined from available sources of data; and short-term liabilities of U.S. nonfinancial concerns to foreigners, such as accounts payable, are not classified as liquid liabilities because they are not transferable and are not considered monetary assets or close substitutes. Claims of this type are not payable on demand, but are terminated or renewed according to the terms of commercial contracts.

Moreover, the necessity of maintaining a sharp distinction between liquid and nonliquid assets and liabilities has, on occasion, posed difficulties for the authorities. The United States, late in 1962, began to sell to official institutions of foreign countries nonmarketable bonds denominated in their currencies. These bonds typically have maturities of 15 months to 2 years and would normally all be classified as long-term liabilities. However, some of these bonds are sold on terms which permit the lender to convert them into the specified currencies on several days' notice. This provision was incorporated to accommodate certain foreign central banks which, despite their stated intention of holding the bonds until maturity, wished or were required to reserve their legal right to earlier repayment. The classification of these bonds in the official balance-of-payments statistics is equivocal. Formally speaking, given a choice between the liquid and nonliquid categories, a bond which may be converted on a few days' notice at the lender's option would have to be regarded as a liquid liability by the borrower.

There has, however, been some difference of opinion as to the liquidity of these bonds from the economic point of view. Some observers have noted that the bonds are regarded by their holders as a part, not materially different from other parts, of their international reserve assets, which they maintain for use in emergencies as well as to finance ordinary payments deficits.² The original intention of the bondholders to retain the bonds until maturity might have to be revised under crisis circumstances that cannot be anticipated. This line of reasoning has led some observers to conclude that the bonds should be regarded as liquid liabilities to the United States on economic as well as formal grounds.

However, other observers have concluded that, considering the stated intentions of the lenders and the inherent advantages of holding these bonds to maturity, the liquidity of the convertible bonds from the economic viewpoint may be regarded as much closer to nonconvertible bonds of the same maturity than it is to the foreign holdings of U.S. Treasury bills and demand deposits. This example illustrates that the economic distinction between liquid and nonliquid assets and liabilities may in some instances be less clear cut than the formal distinction.

Sometimes difficulties of classification arise from inadequacies of available data. For example, the reporting authorities recognize that foreign holdings of marketable Treasury bonds and notes should be classified as liquid or nonliquid liabilities depending on whether the particular bonds and notes purchased or sold by foreigners have less or more than 1 year before their due dates. But available information does not suffice to sort out foreign holdings into these two groups. It is known, however, that the bulk of foreign-held Treasury bonds and notes are in the possession of foreign monetary authorities, and acquired when, regardless of their original maturities, these obligations are nearly due.³ Therefore, all Treasury bonds and notes held by foreigners are classified as liquid liabilities, even though some small part which cannot be measured is known to consist of obligations with more than 1 year remaining to maturity.

The same difficulties of measurement affect the classification of foreign holdings of U.S. State, local, and corporate bonds. Here, also, the authorities cannot determine what part of foreign holdings matures in less than 1 year and what part in more. But there is reason to believe that foreign holdings of such obligations are concentrated in the long-term maturity range. Therefore, all holdings of these types of bonds are classified as nonliquid.

This exploration of the meaning of the U.S. balance-of-payments deficit has outlined some of the difficulties of measuring changes in the U.S. ability to defend the exchange value of the dollar, and has described some of the difficult decisions that must be made in computing the reported deficits. Yet the deterioration in the U.S. international liquidity position is a real phenomenon, not an optical illusion

² Countries may regard the convertible bonds issued by the United States as reserve assets, while the United States continues in balance of payments deficit, even if they are denominated in their own currencies. For while the United States is in deficit, it is unlikely to hold sufficient amounts of the lenders' currencies to convert the bonds, and would therefore be obliged to buy such currencies with dollars or gold, thereby increasing the lenders' reserves.

³ The monetary authorities of other countries regard Treasury obligations as a useful medium for holding their dollar reserves, because they are able to earn interest without sacrificing significant liquidity. Marketable Treasury bonds nearing maturity are free, to a major extent, of the risk of capital loss if their holders should need to sell them.

which could be changed by using different bookkeeping principles. Other definitions of the deficit would alter the numbers for some years, but would probably not paint a very different picture of the U.S. experience over the long run. A committee appointed by the Director of the Bureau of the Budget and headed by Dr. Edward M. Bernstein is currently reviewing possible alternatives to determine what changes, if any, are desirable.

II. THE NATURE OF THE INTERNATIONAL MONETARY SYSTEM

The importance of measuring changes in the ability of the monetary authorities to defend the dollar stems directly from the nature of the existing international monetary system, in which exchange rates are maintained at stable levels. Under the Articles of Agreement of the International Monetary Fund (IMF), member countries have committed themselves to preventing variations in the spot exchange rates of their currencies from exceeding 1 percent of par. The preference for exchange rate stability among countries did not, of course, originate in these Articles of Agreement, but only found expression there.

If foreign exchange markets were free from governmental control or intervention, exchange rates would fluctuate freely, in response to supply and demand pressures. The demand for foreign exchange stems from all transactions involving payments to foreign residents for purchases from them of goods, services, securities, and other financial assets, and transfers to them of gifts, pensions, debt repayments, and so forth. The supply of foreign exchange stems from foreigners' comparable transactions with U.S. residents. The balance between the free market forces of supply and demand normally changes over time and, in the absence of official intervention, such changes would result in variations in exchange rates.

If exchange relationships were widely believed to be in basic equilibrium, small variations in exchange rates would induce private transactions of an offsetting nature, motivated by the desire to profit from the anticipated return of the exchange rate to its equilibrium level. Under such circumstances, exchange rates could be stable, even if the monetary authorities did not intervene. If, however, confidence in the underlying stability of exchange rates were low, exchange rate fluctuations could be large, and pressures could arise for exchange rates to move persistently in one direction.

To permit exchange rate variations to the range permitted by the IMF Articles of Agreement, monetary authorities enter the market as buyers or sellers of foreign exchange to the degree necessary to maintain stability. When the demand for their own currency causes that currency to increase in international value, the authorities add to the available supply by selling it in return for foreign exchange; and when the demand for their currency is weak and it falls in international value, they buy it, offering foreign exchange or gold in payment. A country's ability to keep its exchange rate from rising is greater than its ability to prevent a change in the opposite direction, because it will almost certainly exhaust its available stock of gold and foreign exchange, and its capacity to borrow foreign exchange, before it finds itself unable to generate sufficient quantities of its own currency to keep its exchange rate from appreciating.

Other countries have generally bought or sold dollars in conducting their stabilization operations. The supply of dollars available to

these countries had its origin principally in the postwar balance-of-payments deficits of the United States. Their desire to acquire and willingness to hold dollars has depended to an important degree on the U.S. policy of selling gold to foreign governments and central banks at the fixed price of \$35 per ounce. The foreign authorities, having acquired dollars in the course of their foreign exchange activities, have from time to time reduced dollar holdings which they regarded as excessive by selling dollars to the United States for gold. Until 1962, the United States left the day-to-day task of intervening in foreign exchange markets to the monetary authorities of other countries and confined itself, in fulfilling its International Monetary Fund obligations, to buying or selling gold on demand. However, in 1962, the United States also began to operate directly in the foreign exchange markets, using foreign exchange from debt repayments, foreign borrowings, and currency swaps.

The policy of standing ready to buy all gold offered to it at \$35 an ounce is important, even though the United States is, and has for some time been, a net seller of gold. The U.S. commitment to buy back gold at the selling price, less a nominal service charge, assures present purchasers that the money value of their acquisitions will be preserved, and contributes importantly to making gold a universal currency.

The problem of international liquidity is directly linked to the maintenance of fixed exchange rates. If the monetary authorities left the determination of exchange relationships to free market forces, they would require no extensive international reserves. They would, however, still need international reserves to safeguard the national security and cope with emergency situations. And they might, from time to time, wish to intervene in foreign exchange markets to prevent violent exchange rate fluctuations which could disrupt normal international economic relationships and threaten the stability of domestic price and cost levels. The amount of gold or foreign exchange needed to maintain stability in foreign exchange markets depends on the desired degree of stability, and on the strength, direction, and persistence of the forces tending to change the exchange rate. If countries were required to maintain exchange rates at perpetually fixed levels, and if nothing were done to improve and accelerate the internal economic adjustment mechanism, some would probably need international liquidity in amounts which would be considered vast by present-day standards, while others would be faced with the prospect of providing large amounts of credit or gaining massive reserves. Changes in the economic circumstances of the world's trading countries, however, need not produce changes in equilibrium exchange rate relationships, particularly if countries coordinate national policies with a view to maintaining international equilibrium. But experience has shown that currency revaluations, at least for nonreserve currencies, are made necessary from time to time by changing circumstances and existing limits to the international liquidity available to the deficit countries.

The IMF rules fall substantially short of requiring rigidly fixed exchange rates. Indeed, the Fund recognizes that changes in exchange rates may be necessary if international equilibrium is to be maintained. The Fund's Articles of Agreement provide that members may propose changes in their exchange rates "to correct a fundamental

disequilibrium," although the Articles do not define what constitutes such a disequilibrium.

Moreover, the Fund's rules permit some day-to-day economies in the use of international reserves through the provision that member countries may allow their spot exchange rates to vary within 1 percent of par in either direction. Deviations in the case of forward exchange rates are permitted up to limits that "the Fund considers reasonable." Modest changes in relative international price levels resulting from these limited exchange rate variations may promote equilibrating adjustments in private international transactions and thus reduce the volume of necessary reserves.

The significance of exchange rate stability varies greatly from country to country, and is generally proportional to the international economic importance of the particular country concerned. Changes in the par values of small countries frequently go unnoticed by outsiders, except by specialists, while even modest changes in the rates of industrial countries, such as the 5-percent appreciation of the German mark and the Dutch guilder in 1961, generally provoke widespread interest and may, as in the case of the two currencies mentioned, induce substantial and destabilizing speculation if further currency revaluations are anticipated.

Changes in the par values of the two reserve currencies—the dollar and pound sterling—would differ in significance not only quantitatively but qualitatively from changes in the value of any other currency. The reason is that these currencies are used to settle the bulk of all international transactions and to supplement gold in the international reserves of other countries. They thus contribute an element of international liquidity without which the international monetary system could not continue to function in its present form.

The countries that hold dollars do so voluntarily, and each decides for itself the quantities to be held, in absolute terms or in relation to gold. Membership in the sterling area is optional, but implies certain responsibilities with respect to reserve management. Holdings of reserve currencies are an attractive alternative to gold because they earn interest. On the other hand, they expose the holding countries to the possibility of loss if the reserve currencies are devalued. Such devaluation could therefore seriously disrupt the international monetary system, for afterward the reserve currencies might no longer be trusted as a store of international value. The loss of reserve status by the dollar and pound could force a dramatic contraction of international liquidity, since reserve currency holdings presently constitute a large part, 36 percent, of total international reserves, as well as virtually all of international working balances.

III. THE U.S. INTERNATIONAL LIQUIDITY POSITION

These comments on the role of reserve currencies emphasize that the ability of the United States to defend the value of the dollar is of vital importance, not only from the national point of view, but from the viewpoint of the international monetary system. Suppose that we examine this ability in terms of the relationship between outstanding claims against the dollar and the liquid resources controlled by or automatically available to the monetary authorities—the terms of reference applied to the measurement of the U.S. balance of payments.

On the side of the claims which may be brought to bear on the dollar, it is possible, of course, to indicate the claims which existed as of a given point in time, the change in their magnitude during a given period, and to analyze their composition and the likelihood that they will be presented for redemption into foreign exchange or gold. But the potential foreign claims against the dollar far exceed those outstanding at any moment in time, for, in the event that confidence in the dollar were severely impaired, American residents owning dollar assets could sell such assets for foreign exchange and thus increase foreign monetary authorities' holdings of dollars. The importance of this consideration is evident when we compare liquid liabilities to foreigners amounting to \$26.7 billion at the end of June 1963 (see table 1), with the U.S. domestic money supply of \$148.2 billion and time deposits of \$105 billion also outstanding at the end of June 1963. In the event of a capital flight from the United States, some of these and other domestic assets could theoretically be translated into foreign exchange and, in the process, become claims against U.S. international assets. In practice, however, no massive conversion of domestic into international assets is likely to occur. In the past, even during periods of rapid inflation and currency devaluation, residents of the countries affected tended to flee from their own currencies into real assets, such as goods and real estate, rather than into foreign currencies.

The likelihood of an exchange crisis that would result in massive capital flight from the United States depends not only on the present relationship between liquid assets and liquid liabilities, although that is probably an important element in most cases. Fear of the outbreak of nuclear war, in which the productive assets of the United States could suffer grave damage, might provoke capital flight from the United States even if U.S. liquid assets significantly exceed liquid liabilities. On this score, however, the expanding network of international monetary cooperation of the past few years has enhanced the free world's capacity to cope with capital flight. It may also have contributed to a calming of speculators' nerves; the crisis atmosphere surrounding the United States-Soviet showdown over Cuba in October 1962 resulted in far less speculative capital outflow than the Berlin crisis 2 years earlier. Moreover, speculators might find some difficulty, if they anticipated the outbreak of nuclear war, in deciding what would be a safe haven for their funds.

Under conditions in which the basic health and viability of an economy are not widely questioned, the existing relationship between liquid assets and liabilities is less likely to undergo sharp and sudden change, and is therefore a more useful indicator of a country's ability to defend the value of its currency than it would otherwise be. Suppose that we examine the amount and composition of U.S. international reserve assets and the liquid claims against these assets, with a view to assessing the degree of vulnerability of the U.S. position.

TABLE 1.—Statement of U.S. Government liquid assets and liabilities, June 30, 1963

	<i>Millions</i>
U.S. liquid assets:	
Gold.....	\$15, 830
Convertible currencies.....	126
IMF gold tranche.....	1, 109
Total.....	17, 065
U.S. liquid liabilities, by type of holder:	
International and regional organizations.....	1, 822
Foreign central banks and governments, the Bank for International Settlements and European Fund.....	12, 358
Private foreign holdings.....	8, 635
Foreign holdings of U.S. Government bonds and notes, not identified as to holder, but believed to be mostly official reserve assets...	2, 478
U.S. currency held abroad (rough estimate), not identified as to holder.....	906
Nonmarketable medium-term convertible U.S. Government obligations held by foreign central banks or governments.....	502
Total.....	26, 701

¹ Excludes dollar holdings of the IMF of \$3,016 million; includes \$800 million invested by the IMF in U.S. short-term marketable securities.

Sources: Board of Governors of the Federal Reserve System "Federal Reserve Bulletin," and International Monetary Fund "International Financial Statistics."

On the liability side, not all short-term claims against the United States held by foreigners are included: Short-term claims (such as accounts receivable) of foreigners on U.S. non-financial corporations amounted to \$630 million at the end of March 1963. The latter are not regarded as liquid liabilities of the monetary authorities because they are held by foreigners in connection with commercial relationships.

The U.S. liquid international position was fairly secure on June 30, 1963, in terms of the assets and liabilities shown in table 1, even though liquid liabilities were \$26.5 billion while liquid assets were only \$17.1 billion. Liquid liabilities to international institutions are mainly to the IMF and the IBRD, neither of which is likely to use its dollar holdings in such a way as to place a strain on U.S. reserves. The IMF, one of whose basic functions is to provide for increased international liquidity, would scarcely use its dollar holdings in a manner which would seriously impair the U.S. liquidity position. Indeed, in its balance-of-payments assistance to other countries, the Fund has carefully limited drawings in dollars to avoid the leakage of its liquid dollar holdings into the reserves of the surplus countries where they would become immediate claims on the U.S. gold stock. And the Fund acquired its holdings of U.S. liquid liabilities by selling \$800 million of its gold to the United States, under a repurchase agreement, in return for interest-earning U.S. Treasury bills. The IBRD has encountered a shortage of bankable development projects, and, far from adding dollars into the payments stream flowing through the less developed countries into the reserves of the surplus countries has actually enjoyed a net inflow of dollars through repayments, interest receipts, loans sold, and new bond issues. However, it was announced at the 1963 annual meetings of the Board of Governors of the IBRD that the World Bank would in the future pursue a more liberal lending policy.

Central bank and private foreign holdings of dollars probably consist to a large degree of working balances for international transactions. Central bank dollar holdings are a direct claim on the U.S. gold reserve, but international monetary cooperation has reduced the danger of widespread sales of dollars for gold. Of the dollar balances recorded as privately held, a large part are either deposits of foreign monetary authorities with foreign private banks, or holdings of private banks under contracts with their central banks for the exchange of dollars for national currencies at specified future dates and exchange rates. Under U.S. reporting procedures, the ultimate owner of foreign dollar deposits cannot always be identified.

Foreign private dollar holdings can readily be converted into official holdings. If private holders sold their dollars on the foreign exchange markets, the exchange rate would tend to fall to the support level, and the monetary authorities would intervene by buying the dollars with their national currencies. The monetary authorities would thus absorb the excess of privately supplied over privately demanded dollars at the support level exchange rate. In this way foreign private dollar holdings, which are not a direct claim against U.S. gold reserves, could quickly become such a claim if private holders lost confidence in the dollar. Indeed, foreign private dollar holders may be more responsive to changes in market psychology than cooperating central banks, and may thus pose a greater potential threat to U.S. reserves.

On the asset side, a large portion of the U.S. gold stock is required by law as reserve against the domestic currency. The Federal Reserve Act provides that every Federal Reserve bank must maintain reserves in gold certificates of no less than 25 percent against its deposits and its Federal Reserve notes in actual circulation. In addition, the U.S. Treasury must also maintain a gold reserve against U.S. notes outstanding. The free gold reserves of the United States are then computed by subtracting the sum of the Federal Reserve and Treasury reserve requirements from the total gold stock of the United States.

On August 31, 1963, the Federal Reserve's cover requirement was \$12,260 million, and the Treasury's, \$156 million. Since the U.S. gold stock was \$15,634 million on that date, the free gold stock was \$3,218 million. The free reserves have diminished rapidly, on the one hand, because Federal Reserve note and deposit liabilities have increased and, on the other hand, because gold has been drained from U.S. stocks by sales to foreigners and to qualified domestic buyers. Between August 31, 1962, and August 31, 1963, gold required as reserves increased \$405 million, while \$506 million of gold was lost from Treasury stocks to foreigners and qualified domestic buyers.

In his balance-of-payments message on February 6, 1961, the President stated that gold can be freed from the existing Federal Reserve regulations, and he pledged that "the full strength of our total gold stocks and other international reserves stands behind the value of the dollar for use if needed."

Under the Federal Reserve Act, the Board of Governors is authorized (sec. 11, par. 4) to suspend gold reserve requirements "for a period not exceeding 30 days, and from time to time to renew such suspension for periods not exceeding 15 days * * *." There is no stated limit on the number of such renewals which may be permitted. Upon suspending the requirements, however, the Board must establish a tax graduated upward with the amount of the deficiencies.

Chairman Martin of the Board of Governors has summarized provisions for this penalty tax as follows:

The tax could be very small for as long as the reserve deficiencies were confined to the reserves against deposits and the first 5 percentage points of any deficiencies against Federal Reserve notes. If the reserve deficiencies should penetrate below 20 percent of Federal Reserve notes outstanding, the tax would undergo a fairly steep graduation in accordance with statutory specifications.

The Federal Reserve Act further specifies that, should the reserve deficiencies fall below the 25-percent requirement against notes, the amount of the tax must be added to Reserve bank discount rates. But if the reserve deficiencies were confined to reserves against Reserve bank deposits, the required penalty tax could be nominal and no addition to Reserve bank discount rates would be necessary.⁴

The gold reserve requirement has become a controversial public policy. It is generally acknowledged that the requirement serves no function in limiting the domestic money supply that could not equally well be provided by alternative means. But some feel that it serves a useful purpose in restraining expansionary policies by the Federal Government and in disciplining the Government to follow policies to restore and maintain balance-of-payments equilibrium. They believe that public officials would be reluctant to bring things to such a pass that the suspension machinery of the Federal Reserve, with all of its attendant publicity, would have to be set in motion.

Perhaps this attitude inadequately weighs the possibility that gold losses to foreigners could continue at a substantial rate even under conditions of a balanced budget and even if the objective of international payments balance were realized more rapidly than is now anticipated. The existing dollar holdings of other countries are large, and there is reason to believe that some countries, not wishing to place pressure on the dollar while the United States is in balance-of-payments deficit, are holding somewhat greater dollar balances than they might otherwise desire. If the U.S. payments deficit were eliminated and the position of the dollar strengthened, such countries might make the gold purchases that they had deferred. Thus, elimination of the U.S. payments deficit could temporarily accelerate the gold outflow.

It would seem to be only prudent, in view of the rate at which the so-called free reserves have been shrinking, to allow for the possibility that they will be eliminated altogether in the next 2 to 3 years. On the basis of such short-term projections, some feel that it would be advisable to reduce the statutory reserve requirement now rather than wait for the seemingly inevitable action of the Board of Governors. Others favor reduction of the reserve requirement, but recommend delay until confidence in the dollar is high. However, many experts have concluded that the continuing decline in free gold reserves, quite apart from the accompanying growth of liquid claims against the dollar, makes it appear questionable whether confidence will improve rapidly enough to justify delay. Indeed, delay itself could at some point foster a decline in confidence, if official foreign dollar holders should become anxious concerning their continuing ability to buy U.S. gold at \$35 an ounce.

In terms of the balance sheet of June 30, 1963, the U.S. net liquidity position was negative, but examination of the various categories of U.S. liquid liabilities is reassuring with respect to the ability of the United States to defend the dollar against the liquid liabilities that

⁴Remarks before the American Economic Association and American Finance Association, Dec. 29, 1962.

are the most immediate claims against U.S. reserves. Yet there is no room for complacency. The U.S. international liquidity position is no longer as strong as it was in earlier years, and the achievement of a better balance in the U.S. international accounts has become an important objective of national policy

IV. THE UNITED STATES AS INTERNATIONAL BANKER

The United States performs in the international monetary system some of the functions that are provided within domestic economies by commercial banks. Such banks typically have greater liquid liabilities than liquid assets and would not be regarded efficient as businesses if they did not. Thus, by analogy with commercial banks, the U.S. international liquidity position is normal. And the U.S. position appears favorable in comparison with that of the British who manage the only other reserve currency. On June 30, 1963, the liquid assets, including the IMF gold tranche position, of the British monetary authorities were 40 percent of liquid sterling liabilities to foreigners, while the comparable U.S. ratio was 64 percent.

Unfortunately, the analogy between the monetary authorities of a reserve currency and a commercial bank is imperfect in certain important respects. The ability of a commercial bank in the United States to increase its liquidity is relatively much greater than the corresponding capacity of monetary authorities to increase their international liquidity. Commercial banks, as do all businesses, have assets to correspond to their liabilities. And they are able to arrange the composition of their assets in such a way that these assets fall along a nearly continuous spectrum of liquidity—ranging from cash, to Treasury bills, Government bonds of increasing maturity, State, local, and corporate bonds, and commercial, industrial, and agricultural loans. Broad national markets exist where, if need be, many of these types of assets may normally be sold quickly and with little, if any, capital loss.

In the past, during national crises of confidence, when the banking system as a whole attempted to liquidate its portfolio of securities, the national securities markets could not serve as a means of increasing the liquidity of the entire banking system. For, under such circumstances, one bank's liquidity gain was another bank's loss. Experience with numerous banking crises led the United States to establish the Federal Reserve System—with authority to buy certain assets from the commercial banks or to lend against such assets, and the Nation thereby made great progress toward overcoming the main defect of the previous system—that in times of emergency the banking system as a whole could not convert illiquid assets into cash. Of course, the experience of the early 1930's demonstrated that further progress was needed along these lines, and resulted in a strengthening of the Federal Reserve System. Other countries have established central banks which perform the same functions as the Federal Reserve System.

But unlike commercial banks, the U.S. monetary authorities lack international assets to correspond in amount to their liquid liabilities, and while they can turn to the IMF as an international lender of last resort, the Fund can only transfer limited resources while central banks, the national lenders of last resort, can create money. Had the United

States generated its liquid liabilities to foreigners exclusively by importing more goods and services than were exported, the country as a whole—the private sector as well as the Government—would lack international assets to correspond to its liquid liabilities. But, as a matter of fact, U.S. investments abroad have been so large that the international assets of the United States as a whole grew even faster than liquid liabilities. The difficulty is that the monetary authorities must stand ready to meet the liquid claims against the dollar, while the assets belong chiefly to private parties in the United States who could not, under normal circumstances, be compelled or induced to turn them over to the authorities. Moreover, financial institutions hold a relatively small share of the privately owned international assets, so that the very institutions which might, in the normal conduct of their business, sell international assets to finance capital outflows are not in a position to do so on a material scale.

While the IMF provides valuable credit facilities to nations with balance-of-payments deficits, these facilities are modest in terms of the demands for liquidity which might result from a crisis of confidence in one or both of the key currencies. The IMF plays an important role in international finance, but does not do for the world what a national central bank does for its country.

Thus, the position of the United States as an international banker must be carefully distinguished from that of a commercial bank. The United States may well be in stable equilibrium with outstanding liquid liabilities exceeding liquid assets. But, lacking access to liquidity on a scale comparable to that available to commercial banks, the liquidity problem of the U.S. monetary authorities may become more urgent and serious than that of commercial banks which have the same relationship between liquid assets and liabilities, if the U.S. payments deficit is not brought under control.

V. THE U.S. INTERNATIONAL ASSET POSITION

In contrast to its international liquidity position, the U.S. overall international asset position has improved steadily in the postwar years. The United States has borrowed short, as it were, and invested long. The popular characterization of the balance-of-payments deficit is misleading when it suggests that the United States is living beyond its means and spending more than it earns. For these terms conjure up the vision of a spendthrift, who goes into debt to satisfy his desire to consume. Yet the United States has exported more goods and services than it has imported in every one of its deficit years.

The flow of funds abroad for investment, while adding to U.S. long-term international assets, has contributed to the channeling of dollars into the reserves of the surplus countries, and the consequent deterioration of the U.S. liquidity position. If dollars for investment or other purposes flow abroad when the supply of dollars in exchange markets is already abundant, the dollar exchange rate may decline to the support level where the central bank of the country involved will intervene and buy dollars with its own currency. An investor would thus obtain the foreign currency he needs to carry out his investment activities, but the liquidity position of the United States would deteriorate.

In this chain of events, the ultimate credit is provided by the foreign country, which enables the investor to command its goods and services

or financial assets in return for increases in its liquid claims against the U.S. monetary authorities. The foreign government takes the place of a U.S. resident as creditor of the United States with respect to the dollar balances involved, and the United States may be called on to make good on its liabilities by redeeming those dollar balances in gold or foreign exchange instead of in dollars. In this way, American investors placing their funds abroad may contribute to the international liquidity problem of the United States. Paradoxically, if these funds are raised through borrowings in the U.S. long-term capital market, as is frequently done, the liquidity position of the individual investor is protected even while that of the country itself may be eroded.

The flow of funds abroad for investment, while contributing to the annual balance-of-payments deficits, provides a source of strength for the balance of payments in future years through the return flows of interest, dividends, and profit remittances, provided that the higher income on investments is not more than offset by income losses resulting from the substitution of production from overseas subsidiaries for U.S. exports. In 1962, alone, the inflow of these returns, stemming from all private U.S. investments abroad made up to that time, totaled \$3,850 million. Of course, only an extremely small part of these returns can be attributed to the new capital outflows of 1962. The foreign exchange payback period of an investment abroad is almost always longer than 1 year. It would be erroneous, therefore, to calculate the balance-of-payments impact of 1962 investment abroad by subtracting 1962 returns from 1962 outflows.

U.S. private long-term investments abroad, which stood at \$12.3 billion in 1946, exceeded foreign long-term investments in the United States by \$5.3 billion in that year. In 1962, they reached \$52.6 billion, \$32.4 billion greater than the comparable amount of foreign investment in the United States. The rapid growth of these long-term investments benefited to a large degree from the reinvestment abroad of the earnings resulting from foreign direct investments. In 1962, this amount of retained earnings totaled \$1.2 billion (see table 2). The accumulation of assets abroad through the reinvestment of overseas earnings does not appear in the balance-of-payments accounts as a capital outflow, since it involves no movement of dollars abroad.

TABLE 2.—*Undistributed subsidiary earnings of U.S. direct investments abroad, 1950-62*

		[Millions of dollars]	
1950.....	475	1957.....	1,363
1951.....	751	1958.....	945
1952.....	923	1959.....	1,089
1953.....	826	1960.....	1,266
1954.....	702	1961.....	1,054
1955.....	962	1962.....	1,202
1956.....	1,175		

Sources: Department of Commerce "Balance of Payments Statistical Supplement Revised Edition"; and "Survey of Current Business," August 1963.

Table 3 shows the U.S. international asset position in each of the postwar years. In a loose way we could speak of the international "net worth" of the United States, the difference between all international assets and liabilities, as having risen from \$23.5 billion in 1946 to \$48.8 billion in 1962. But differences in the quality and comparability of the various assets and liabilities which enter into the

TABLE 3.—*The U.S. international asset position, 1946-62*

[In billions of dollars]

	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961 ¹	1962 ²
Total U.S. gold stock, and total U.S. assets and investments abroad.....	39.4	48.3	52.5	54.0	54.3	56.4	59.2	60.2	62.4	65.1	70.8	76.5	79.3	82.2	86.7	91.9	96.2
U.S. gold stock.....	20.7	22.9	24.4	24.6	22.8	22.9	23.3	22.1	21.8	21.8	22.1	22.9	20.6	19.5	17.8	16.9	16.1
U.S. assets and investments abroad, total.....	18.7	25.4	28.1	29.4	31.5	33.5	35.9	38.1	40.6	43.3	48.7	53.6	58.7	62.7	68.9	75.0	80.1
Private investments.....	13.5	14.9	16.3	16.9	19.0	20.8	22.7	23.8	26.6	29.1	33.4	36.9	41.1	44.8	50.3	55.5	59.8
Long term.....	12.3	13.4	14.7	15.6	17.5	19.2	21.0	22.2	24.4	26.8	30.4	33.7	37.6	41.2	45.4	49.0	52.6
Short-term assets and claims.....	1.3	1.5	1.6	1.3	1.5	1.7	1.7	1.6	2.2	2.4	2.9	3.2	3.5	3.6	4.9	6.5	7.2
U.S. Government credits and claims.....	5.2	10.5	11.8	12.4	12.5	12.7	13.1	14.3	14.1	14.2	15.3	16.6	17.5	17.9	18.5	19.5	20.3
Long term.....	5.0	9.1	10.2	10.7	10.8	10.9	11.3	12.7	12.5	12.4	12.5	12.8	13.4	13.5	14.1	14.7	16.0
Foreign currencies and short-term claims.....	.2	.3	.2	.3	.3	.3	.3	.3	.4	.7	1.3	1.8	2.1	2.4	2.9	2.9	3.1
IMF position and monetary authorities holdings of convertible currencies.....	-----	1.2	1.4	1.5	1.4	1.4	1.5	1.4	1.2	1.0	1.6	2.0	2.0	2.0	1.6	1.8	1.2
Total foreign assets and investments in the United States.....	15.9	14.5	15.2	15.6	18.4	19.6	21.7	22.7	25.9	28.7	31.4	31.6	35.3	40.0	42.1	46.9	47.4
Long term.....	7.0	6.8	6.8	7.1	8.0	8.8	9.4	9.6	11.6	13.4	14.3	13.8	16.4	18.1	18.4	21.4	20.2
Short-term assets and U.S. Government obligations.....	8.9	7.7	8.4	8.5	10.4	10.8	12.3	13.1	14.3	15.3	17.1	17.8	18.9	22.0	23.7	25.4	27.2
Private obligations.....	5.3	5.3	5.8	5.9	6.5	6.7	7.3	7.6	8.5	8.5	9.5	9.9	10.9	10.9	12.1	13.4	13.3
U.S. Government obligations.....	3.6	2.4	2.6	2.5	3.9	4.1	5.0	5.4	5.8	6.8	7.6	7.9	8.0	11.1	11.6	12.1	13.8

¹ Data for Cuba omitted effective 1961.² Preliminary.

Sources: Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition," "Survey of Current Business," August 1963; and Balance of Payments Division, Office of Business Economics.

totals detract from the usefulness of a "net worth" concept in this connection. In 1962, for example, of \$16 billion of U.S. Government long-term claims against foreigners, roughly \$3 billion were denominated in nonconvertible currencies; and almost all of the \$3.1 billion of U.S. Government holdings of foreign currencies and short-term claims against foreigners were in inconvertible currencies. These assets could not well assist the U.S. authorities in defending the dollar.

Changes in certain key elements in the U.S. international asset position from 1950 through 1962 are shown in table 4. These changes result from both capital flows and valuation changes. Portfolio investments reflect changes in market values, while direct investments do not.

TABLE 4.—Changes in key types of assets and liabilities, 1950-62

[Billions of dollars; increase in U.S. assets (+)]

U.S. private long-term investments abroad.....	+35
U.S. private short-term investments abroad.....	+6
Foreign long-term investments and nonliquid assets in the United States..	-13
Net increase in private and nonliquid investments.....	+28
U.S. monetary reserves (gold, IMF gold tranche position, convertible currencies).....	-7
Foreign-owned liquid assets in U.S. banks and U.S. Government obligations.....	-16
Net decrease in liquid assets.....	-23
U.S. Government credits and claims (inconvertible foreign currency claims +6).....	+8

Source: "Survey of Current Business," August 1963, p. 22.

VI. U.S. EXPERIENCE IN THE POSTWAR PERIOD

The United States was one of the few major trading countries to emerge from the Second World War without physical destruction of its productive capacity. The war over, victor and vanquished nations alike struggled to rebuild and redirect their economies. The demand for the goods and services which the United States could provide swelled to exceptionally high levels at a time when other countries suffered an impaired capacity to earn foreign exchange. The blueprint for a new international trading and monetary order, devised as hostilities drew to an end, required for its realization recovery from the destructive effects of the war.

The United States provided massive economic assistance in the early postwar years to promote economic recovery abroad. From 1946 through 1949, Government grants and loans, largely to Britain, France, and Germany, totaled nearly \$23 billion, and U.S. military spending abroad added almost another \$2.5 billion to the international spending power of other nations.⁵ Never before in its peacetime history, and not since, has the U.S. trade surplus in goods and services been as large as it was in 1946 and 1947. In the 4 years 1946 through 1949, taken together, the U.S. trade surplus exceeded the combined surpluses of the entire last decade, 1953 through 1962. Despite the unprecedented assistance provided by the United States and their

⁵ The data cited in this section are principally from the Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition."

own resort to exchange controls and import restrictions, other countries depleted their foreign exchange and gold reserves to finance their overseas purchases. Their problem was intensified by substantial flows of capital to the United States, appearing chiefly as unrecorded transactions in the U.S. accounts, seeking protection against devaluation or escape from exchange controls. U.S. gold reserves, which were \$20.1 billion at the end of 1945, rose to a high point of nearly \$24.8 billion in 1949, while the dollar holdings of other countries fell nearly \$1 billion during the same period and their gold reserves fell almost \$3.5 billion, not counting their gold contributions to the IMF.

As Europe's economic recovery proceeded at a disappointingly slow pace and difficulties with the Soviet Union multiplied, the United States changed the character of its assistance programs. With the implementation of the Marshall plan in 1948, emphasis was shifted from loans to grants. In the decade 1946-55, U.S. Government nonmilitary grants, net, to certain leading European countries were, in millions of dollars: France, \$3,725; Germany, \$3,692; Italy, \$2,491; the Netherlands, \$838; and the United Kingdom, \$3,741; U.S. Government long-term loans were: France, \$2,461; Germany, \$346; Italy, \$414; the Netherlands, \$388; and the United Kingdom, \$4,783.

In 1949, the alinement of exchange rates was altered on an important scale for the first time since the end of the war. In September of that year, the United Kingdom, most overseas members of the sterling area, Sweden, Norway, Denmark, and the Netherlands devalued 30.5 percent; France, 21.8 percent; West Germany, 20.6 percent; Italy, 8 percent; and Belgium, 12.3 percent. Austria devalued substantially in November 1949, and adopted a multiple exchange rate system.

This series of devaluations was followed by a sharp decline in U.S. receipts from unrecorded transactions and errors and omissions, suggesting that speculation against their own currencies by Europeans may have abated. Gains in the competitive positions of the devaluing countries resulting from their new exchange rates and extraordinary demands arising from the outbreak of the Korean war in 1950 jointly contributed to a sharp increase in U.S. imports relative to exports. At the same time, American military spending abroad increased dramatically. The U.S. trade surplus in goods and services fell severely to an average level in the 4 years 1950 through 1953 only one-third of the 1948-49 level; and in 1950 the United States suffered its first large postwar balance-of-payments deficit, nearly \$3.6 billion, and lost more than \$1.7 billion of its gold reserves.

Despite the beginning in 1950 of an almost uninterrupted series of annual deficits in the U.S. balance of payments, little concern over the stability of the dollar was apparent until the late 1950's. Indeed, the greater part of the decade of the 1950's echoed with prophecies that the world faced a chronic dollar shortage. Other countries, still struggling to rebuild their reserves, were glad to hold most of the dollars they were able to earn. Although conversions of dollars into gold were by no means uncommon in the early 1950's, gold losses tended to be followed by gains, and no continuing trend of losses was evident. In the period 1950 through 1957, the U.S. gold stock declined only \$1.7 billion. The abnormal conditions of the Korean war which contributed to the first large postwar deficits were recognized as nonrecurring. And it was not anticipated that the large outflows of funds under the

Government's aid and military programs would be as durable as they later proved to be. Moreover, in all but two of the postwar deficit years before 1958, the year-to-year changes in the U.S. international liquidity position were modest. Had U.S. deficits continued at yearly levels ranging around \$1 billion to \$1.5 billion, it seems reasonable to suppose that the stability of the dollar would not have been brought into question. Increases in the dollar reserves of other countries at a rate of this general magnitude would probably be appropriate in view of the growth of international transactions.

But 1958 witnessed a dramatic deterioration in the U.S. international accounts. The favorable balance on goods and services account, which in 1957 had nearly regained the high levels of the late 1940's, fell sharply in 1958 and almost disappeared in 1959. The overall U.S. deficit in 1958 exceeded \$3.5 billion and, following 2 years of increase, gold reserves declined nearly \$2.3 billion, the largest annual gold outflow in American history. The deficit increased further in 1959, while the trade surplus fell by more than \$2 billion. In that year, the United States lost more than \$700 million in gold. When the U.S. deficit rose still further in 1960 to the highest level ever recorded for the United States, it became evident for all to see that market attitudes toward the dollar had changed. This change was dramatized in the fall of 1960 by an outbreak of gold speculation which, for a brief period, raised gold prices on the London market above \$40 an ounce.

Concerned over continuing deficits, the United States has taken steps in a large number of ways to promote equilibrium in the balance of payments. These measures, which will be discussed below, helped to bring about reductions in the recorded deficits of 1961 and 1962, although, if allowance is made for special Government transactions, no decisive improvement in the balance of payments has yet become evident. And it now appears that the deficit in 1963 will not be much, if at all, smaller than that of 1962. Improvement in the U.S. international economic position must therefore continue as a prime objective of public policy.

VII. CAUSES OF THE PAYMENTS DEFICIT

In 1950, when the United States suffered its first large balance-of-payments deficit of \$3.6 billion, total U.S. receipts from all international transactions were \$13.9 billion. In 1962, U.S. receipts were more than double the 1950 level; they reached \$32.1 billion, the highest level on record. But the deficit continued to exceed \$2 billion. (See table 5.) Clearly the difficulty has not been that receipts have failed to rise rapidly but rather that, however rapid their increase, payments have risen even quicker. In relation to total U.S. international payments or receipts, the balance-of-payments deficits are small. Why have they failed to respond more promptly to therapy?

In theory, balance-of-payments deficits should be eliminated through the operation of market forces set in motion by the deficits themselves. Deficits tend to have adverse effects on income levels in the country losing liquidity and surpluses have opposite effects in the country gaining it; the deficit country therefore tends to import less, while the surplus country tends to import more. The decline in the international liquidity of the deficit country tends to be accompanied by a shrinkage in its domestic liquidity. Opposite changes occur in the

surplus country. As a result, interest rates tend to rise in the deficit country and fall in the surplus country, thus providing incentives to export or repatriate capital to the deficit country. This tendency is reinforced by the expansionary effects of the balance-of-payments disequilibrium on the funds available for investment in the surplus country and its contractionary effects in the deficit country.

TABLE 5.—U.S. balance of payments, 1946–62

(Millions of dollars)

	Total receipts ¹ (credits)	Total payments ¹ (debits)	Surplus (+) or deficit (-)	Financing the deficit			
				Change in liquid liabilities (increase -)	Change in U.S. monetary reserve assets (decrease -)		
					IMF position ²	Convertible currencies	Gold
1946.....	14,583	13,322	+1,261	+638	(³)	0	+623
1947.....	20,598	16,031	+4,567	+1,252	+1,153	0	+2,162
1948.....	17,795	16,790	+1,005	-731	+206	0	+1,530
1949.....	16,628	16,453	+175	-91	+102	0	+164
1950.....	13,897	17,477	-3,580	-1,822	-15	0	-1,743
1951.....	19,464	19,769	-305	-338	-20	0	+53
1952.....	18,805	19,851	-1,046	-1,461	+36	0	+379
1953.....	17,464	19,616	-2,152	-896	-95	0	-1,161
1954.....	18,172	19,722	-1,550	-1,070	-182	0	-298
1955.....	20,701	21,846	-1,145	-963	-141	0	-41
1957.....	24,791	25,726	-935	-1,804	+563	0	+306
1958.....	28,125	27,605	+520	-645	+367	0	+798
1959.....	29,577	27,106	+2,471	-1,237	-17	0	-2,275
1960.....	24,751	28,494	-3,743	-2,708	+40	0	-1,075
1961.....	30,313	31,857	-1,544	-1,738	-441	0	-1,702
1962.....	32,093	34,279	-2,186	-1,764	+135	+116	-857
				-658	-626	-17	-890

¹ Receipts include net credits on errors and omissions and net movements of foreign capital; payments include net debits on errors and omissions and net movements of U.S. capital. Goods and services transferred under military grants are excluded.

² The IMF position is the gold tranche position, which measures the amount the United States may draw essentially automatically from the Fund.

³ Not applicable.

Sources: U.S. Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition"; "Survey of Current Business," June 1963; and Balance of Payments Division, Office of Business Economics.

Moreover, these changes in domestic liquidity, and the income effects already noted, place upward pressures on costs and prices in the surplus country and downward pressures in the deficit country, thereby improving the deficit country's competitive position and leading to an equilibrating adjustment in its trade balance. All of these forces continue to operate until the deficit is ended.

While theory correctly described the market forces which international imbalances set into motion, these forces themselves tended to be increasingly offset by national policies designed to promote full employment and price stability. Countries today have a strong aversion to allowing deficits in their international accounts to produce deflation and unemployment, and surplus countries are reluctant to permit inflation. Much has been heard, in connection with proposals for reforming the international monetary system, of the loss of sovereignty which may be inherent in this or that plan. It is relevant to observe that the functioning of a competitive international economy, free from exchange controls, quantitative restrictions, and other absolute limitations on international transactions, necessarily subjects national economies to influences originating abroad which they may or may not welcome. Depressed conditions abroad tend to cause a

decline in exports, a deficit in the balance of payments, and a sequence of deflationary developments in the domestic economy. Conversely, inflation abroad induces expansion at home. It is perhaps not unnatural that governments should wish to achieve a greater measure of independence from economic forces arising from circumstances beyond their control and outside the territorial limits of their authority.

Whatever may be said for insulating the domestic economy from outside influences, the use of monetary and fiscal policies to preserve domestic stability has weakened the self-correcting tendencies of international payments disequilibrium. It would be a mistake, however, to believe that such tendencies have been completely nullified. They could be, in principle, although with difficulty. But in practice, deficit- and surplus-induced equilibrating forces appear to have been damped, not eliminated. Indeed, while pursuing its own program for achieving a better international balance, the United States may also benefit from a continuation of cost and price increases in the surplus countries which have their origin, in large part, in the growth of their international reserves.

In general, it is obvious that any balance-of-payments deficit is fundamentally caused by a failure of market adjustments and policy measures. But what are the particular causes of the U.S. postwar deficits? For an answer to this question, we must turn to the major items in the U.S. international accounts and attempt to determine their respective contributions to the overall deficit.

It is an unfortunate aspect of the structuring of accounting statements that they easily lend themselves to the mistaken interpretation that the various categories of payments and receipts are independent of each other. Just as a business could not generally expect that the elimination of its advertising expenditures would increase pretax profits by the amount of the elimination, so the United States could not hope to accomplish overall balance-of-payments savings equal to the reductions that might be achieved in any particular payments account. Expenditures have their counterparts in receipts through a series of so-called feedback effects. Sometimes these effects are immediate and direct. Certain U.S. private investments abroad and a large portion of the Government's grants and loans never take the form of cash outflows, but directly involve exports of goods. Even when outflows of liquid funds take place, they may be closely linked with exports of goods and services. Short-term capital outflows, for example, often serve to finance exports which could not have been sold in the absence of the financing. On the other hand, some forms of payments quickly find their way into the reserves of the surplus countries and result in little, if any, counterbalancing effect on exports.

Ideally, we would be able to measure the net adverse effect of the various expenditure items in the balance of payments, taking into account all feedback effects. But precise measurement in this area is impossible. In the case of direct investment, for example, the feedback effects themselves are multiple and conflicting. A particular direct investment appears in the balance-of-payments accounts as an outflow of capital, and it usually gives rise to a return flow of profits, dividends, or interest. It may result in higher exports, initially through shipments abroad of machinery and equipment to construct overseas facilities, and later through exports of raw materials,

components, and parts for processing and assembly in the new facilities. Moreover, subsidiaries abroad may assist an American corporation in marketing finished products complementary with, but different from, the products manufactured abroad. These favorable effects, however, may be offset, or even more than offset, by the loss of foreign markets for U.S. finished products as a consequence of the production and sale abroad by American subsidiaries of goods that might otherwise have been exported from the United States. And American exports to third countries may suffer if such markets are served by the new overseas subsidiaries instead of by the parent companies. Moreover, American companies may find it profitable to supply domestic markets from their subsidiaries abroad instead of from domestic production, thereby swelling imports. These examples of displacement do not necessarily indicate balance-of-payments losses to the United States equal to the amount of the displacements, for in each case it is possible that, had American capital not taken advantage of available opportunities abroad, foreign capital would have done so. And in that event, the United States would not enjoy the offsetting benefits of profit and interest remittances.

It follows that the capital outflows reported in each balance-of-payments statement under "direct investments" are an inadequate measure of the actual overall balance-of-payments impact of such investments. The accompanying adverse or beneficial effects of direct investments, however, appear in the service and merchandise accounts, where they cannot be linked with the investment with which they are associated, or they may not appear in the data at all if exports are kept from expanding to levels they would otherwise have reached.

The Government's economic assistance programs provide another illustration of the difficulties of measuring the adverse balance-of-payments effects of certain payments elements. Some aid programs, such as the disposal of surplus food under Public Law 480, take the form of transfers in kind rather than cash. Such transfers are now recorded in the U.S. balance-of-payments accounts as transactions involving no immediate dollar outflow from the United States. But some part of the products distributed under these aid programs would probably have been sold on a commercial basis in the absence of the Government's programs. Thus, even when aid programs involve no flows of liquid funds, they are likely to have some adverse impact on the balance of payments. On the other hand, when aid does take the form of cash transfers, the actual balance-of-payments effects are probably less than would appear to be indicated by the size of the outflows, because some of the funds are returned to the United States through normal commercial and financial channels. Because of these complexities, the balance-of-payments advantages of tying aid to purchases of American goods and services may be less than is suggested by the proportion of aid funds tied. If countries normally spend the bulk of their foreign exchange earnings in the United States, as do the Latin American countries, the requirement that particular dollar balances be used in the United States may result in the diversion to third countries of dollars which would otherwise have been spent here, without any balance-of-payments advantages to the United States as a result of the tying. In practice, however, tying is likely to have some favorable impact on the balance of payments.

As is the case with private investments, the adverse balance-of-payments effect of a given dollar outflow for aid is less when it is directed

to countries which normally trade chiefly with the United States. A recent study by the Brookings Institution investigated the problems of measurement in this area.⁶ Its estimates suggest that, of expenditures by the Agency for International Development in 1961, approximately 64 cents of every dollar directed to Latin America returned to the United States, in contrast to only 44 cents of every such dollar destined for Africa.

These examples give some indication of the difficulties of attempting a quantification of the actual balance-of-payments consequences of particular payments items. But even if no exact measurement is possible, it seems likely that each major payments category contributes something to the deficit. It does not follow, however, that all increases in payments of the same type result in greater balance-of-payments pressures. For example, the adverse balance-of-payments impact of aid programs, following an overall increase in expenditures, may actually be less than before if aid programs are curtailed in countries trading principally with Europe and expanded in countries trading principally with the United States. And it does not follow that equal expenditures in the same places for different purposes have the same balance-of-payments repercussions. Expenditures for the support of military forces in Europe probably have a greater adverse impact on the balance of payments than equal sums invested in manufacturing subsidiaries there.

Bearing in mind these complications, let us examine some of the major elements in the U.S. balance-of-payments accounts which have exhibited important changes in recent years (see table 6). The travel account is perhaps most noteworthy for its persistent year to year increase (see table 7). The immediate dollar outflow from travel reached more than \$1.4 billion in 1962, the highest level in history, having virtually doubled since 1955 and quadrupled since 1949. Military spending abroad, net of receipts from military sales, trended upward from the end of the Second World War to a peak of \$3.1 billion in 1958 (see table 8). Thereafter, it declined somewhat and military receipts increased substantially. As a result, net military spending fell each successive year to \$2.4 billion in 1962, the lowest level in a decade and nearly 25 percent below the 1958 peak.

⁶ Walter S. Salant et al., "The United States Balance of Payments in 1963" (Washington: The Brookings Institution, 1963), pp. 155-190.

TABLE 6.—The U.S. balance of payments on current account, 1946-62

[Millions of dollars]

	Goods			Services									Total goods and services		
	Exports ¹	Imports	Balance	Total			Detail						Exports ¹	Imports	Balance
				Exports ¹	Imports	Balance	Transportation, net	Travel, net	Miscellaneous services, net	Income on investments, net		Military spending, net ²			
										Private	Government				
1946.....	+11,707	-5,073	+6,634	+3,028	+1,918	+1,110	924	-191	310	554	6	-493	14,735	6,991	7,744
1947.....	+16,015	-5,979	+10,036	+3,722	+2,229	+1,493	1,155	-209	145	807	50	-455	19,737	8,208	11,529
1948.....	+13,193	-7,563	+5,630	+3,596	+2,786	+810	671	-297	175	975	85	-799	16,789	10,349	6,440
1949.....	+12,149	-6,879	+5,270	+3,621	+2,742	+879	538	-308	208	989	73	-621	15,770	9,621	6,149
1950.....	+10,117	-9,108	+1,009	+3,690	+2,920	+770	215	-335	242	1,146	78	-576	13,807	12,028	1,779
1951.....	+14,123	-11,202	+2,921	+4,621	+3,871	+750	582	-284	254	1,317	151	-1,270	18,744	15,073	3,671
1952.....	+13,319	-10,838	+2,481	+4,673	+4,928	-255	373	-290	309	1,267	140	-2,054	17,992	15,766	2,226
1953.....	+12,281	-10,990	+1,291	+4,666	+5,571	-905	117	-355	307	1,283	166	-2,423	16,947	16,561	386
1954.....	+12,799	-10,354	+2,445	+4,960	+5,577	-617	145	-414	305	1,594	213	-2,460	17,759	15,931	1,828
1955.....	+14,280	-11,527	+2,753	+5,524	+6,268	-744	202	-499	299	1,775	180	-2,701	19,804	17,795	2,009
1956.....	+17,379	-12,804	+4,575	+6,216	+6,824	-608	209	-570	447	2,054	40	-2,788	23,595	19,628	3,967
1957.....	+19,390	-13,291	+6,099	+7,091	+7,461	-370	398	-587	482	2,174	4	-2,841	26,481	20,752	5,729
1958.....	+16,264	-12,932	+3,312	+6,803	+7,909	-1,106	2	-635	486	2,008	168	-3,135	23,067	20,861	2,206
1959.....	+16,282	-15,310	+972	+7,194	+8,032	-838	-413	-708	573	2,147	68	-2,805	23,476	23,342	134
1960.....	+19,459	-14,723	+4,736	+7,515	+8,482	-967	-301	-857	621	2,266	17	-2,713	26,974	23,205	3,769
1961.....	+19,913	-14,497	+5,416	+8,398	+8,370	+28	-261	-847	796	2,860	102	-2,532	28,311	22,867	5,444
1962.....	+20,479	-16,145	+4,334	+9,311	+8,819	+492	-306	-844	823	3,194	133	-2,368	29,790	24,964	4,826

¹ Excludes exports transferred under military grants.² From 1946 to 1953 receipts from military transactions were included in other accounts.

Sources: U.S. Department of Commerce, "Balance-of-Payments Statistical Supplement Revised Edition"; and "Survey of Current Business," June 1963.

TABLE 7.—*The travel account, chiefly tourism, 1948-62*

[Millions of dollars]

	U.S. residents spending abroad	Foreign residents spending in the United States	U.S. residents payments to foreign carriers	Receipts from foreign travelers ¹ by U.S. carriers	Net balance of payments on travel
1948.....	-631	+334	-80	+76	-301
1949.....	-700	+392	-107	+62	-353
1950.....	-754	+419	-147	+55	-427
1951.....	-757	+473	-132	+59	-357
1952.....	-840	+550	-172	+74	-388
1953.....	-929	+574	-179	+67	-467
1954.....	-1,009	+595	-183	+70	-527
1955.....	-1,153	+654	-201	+75	-625
1956.....	-1,275	+705	-233	+74	-734
1957.....	-1,372	+785	-261	+93	-755
1958.....	-1,460	+825	-320	+103	-852
1959.....	-1,610	+902	-380	+103	-985
1960.....	-1,745	+887	-513	+110	-1,261
1961.....	-1,747	+900	-515	+112	-1,250
1962.....	-1,905	+921	-563	+117	-1,430

Sources: Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition"; and "Survey of Current Business," June 1963.

Table 8.—*Military expenditures and receipts entering into the balance of payments, 1953-1st half 1963*

[Millions of dollars]

	Gross mili- tary expendi- tures abroad for goods and services	Military cash receipts	Net military expenditures abroad ¹
1953.....	2,615	192	2,423
1954.....	2,642	182	2,460
1955.....	2,901	200	2,701
1956.....	2,949	161	2,788
1957.....	3,216	375	2,841
1958.....	3,435	300	3,135
1959.....	3,107	302	2,805
1960.....	3,045	335	2,683
1961.....	2,934	398	2,536
1962.....	3,028	1,143	1,885
1963, 1st half (seasonally adjusted annual rate).....	2,930	796	2,124

¹ Includes military sales, net advances on military exports, and small miscellaneous transactions.

Sources: Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition"; and "Survey of Current Business," June 1963.

Economic assistance programs, not counting repayments on Government loans, declined in the immediate postwar years from exceptionally high levels. (See table 9.) They reached a low point of \$2.1 billion in 1954, and rose substantially thereafter, attaining almost \$4.3 billion in 1962, nearly double the 1954 level. The balance-of-payments impact of these expenditures has probably increased far less since 1954 than the total dollar amounts would suggest, for the geographic focus of these programs has shifted and, starting in 1959, Government policy has increasingly been brought to bear on the problem of raising the proportion of aid funds spent in the United States. Aid strategy and balance-of-payments measures are described more fully in part II of this volume.

TABLE 9.—U.S. Government grants, loans, and repayments, 1946-62

[Millions of dollars]

	Government grants	Government loans	Total Government grants and loans	Repayments			Total U.S. Government grants and loans net of repayments
				Sched-uled	Non-sched-uled	Total repayments	
1946.....	-2,274	-3,105	-5,379	(1)	(1)	86	-5,293
1947.....	-1,897	-4,518	-6,415	(1)	(1)	294	-6,121
1948.....	-3,894	-1,467	-5,361	(1)	(1)	443	-4,918
1949.....	-4,997	-857	-5,854	(1)	(1)	205	-5,649
1950.....	-3,484	-451	-3,935	(1)	(1)	295	-3,640
1951.....	-3,035	-461	-3,496	(1)	(1)	305	-3,191
1952.....	-1,960	-849	-2,809	(1)	(1)	429	-2,380
1953.....	-1,837	-705	-2,542	(1)	(1)	487	-2,055
1954.....	-1,647	-414	-2,061	(1)	(1)	507	-1,554
1955.....	-1,901	-726	-2,627	(1)	(1)	416	-2,211
1956.....	-1,733	-1,108	-2,841	(1)	(1)	479	-2,362
1957.....	-1,616	-1,617	-3,233	(1)	(1)	659	-2,574
1958.....	-1,616	-1,515	-3,131	(1)	(1)	544	-2,587
1959.....	-1,633	-1,407	-3,040	622	435	1,054	-1,986
1960.....	-1,664	-1,741	-3,405	588	48	636	-2,769
1961.....	-1,854	-2,202	-4,056	606	663	1,274	-2,782
1962.....	-1,903	-2,378	-4,281	617	666	1,283	-2,998

¹ Not available.

Source: Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition"; and "Survey of Current Business," June 1963.

Private capital movements are among the largest and most difficult to analyze of the payments items in the balance of payments. Data collecting is extremely difficult in this area. As a consequence, we cannot accurately measure the amount of capital outflows, let alone their impact on other balance-of-payments accounts. Unrecorded transactions which appear in the account titled "errors and omissions" are believed to be largely U.S. or foreign capital movements.

American private investments abroad increased rapidly after the Second World War, reversing the experience of the 1930's when funds were repatriated. Net U.S. recorded short- and long-term capital outflows reached a level in excess of \$1 billion a year in 1950 and have remained above this amount in every subsequent year except 1953 (see table 10). From 1950 through 1955, the net volume of recorded outflows fluctuated between \$1 billion and \$1.6 billion, save for 1953, when it fell to \$0.4 billion. In 1956, however, recorded outflows spurted to \$3.1 billion, and have since exhibited an erratically rising trend. After declining in 1958 and 1959 from the peak level reached in 1957, they reached new highs in 1960 and 1961, fell back somewhat in 1962, and then surged upward in the first half of 1963 at a seasonally adjusted annual rate of \$5.2 billion.

The composition of recorded capital outflows has undergone marked change since the beginning of the large balance-of-payments deficits of recent years. Long-term capital outflows, which fluctuated around \$1 billion from 1947 through 1955, increased sharply in 1956 and 1957, but then fell back somewhat from the peak 1957 level until the first half of 1963. They then rose to a seasonally adjusted annual rate of nearly \$4.2 billion, almost \$1.5 billion more than the actual outflow of 1962. The sharp increase in the first half of 1963 reflected largely expanding net purchases by U.S. residents of new foreign security issues. Such net purchases were \$573 million in 1960, and \$523

TABLE 10.—U.S. private, capital, net, and errors and omissions, net, 1946-1st half 1963

Recorded flows		[Millions of dollars]							
Errors and omissions, net	Total recorded capital outflow, net	Short-term	Long-term					Direct investment, net	New issues of foreign securities, net
			Total	Other, long-term, net	Transactions in foreign securities	Redemptions outstanding	Transfers		
+195	-413	-310	-103	+35	-131	+308	-85	-230	-230
+936	-987	-189	-798	-85	+137	+295	-396	-749	-749
+1,179	-906	-116	-790	-26	-7	+62	-150	-721	-721
+775	-553	+187	-740	+107	+42	+103	-118	-600	-600
-21	-1,265	+149	-1,116	-220	-322	+301	-254	-621	-621
+477	-1,048	+103	-945	-84	+25	+113	-491	-608	-608
+601	-1,160	-94	-1,066	-127	+133	+66	-286	-852	-852
+339	-383	+167	-550	+94	+25	+113	-491	-608	-608
+173	-1,622	-635	-987	-114	-21	+124	-309	-667	-667
+503	-1,255	-191	-1,064	-261	-42	+190	-128	-823	-823
+543	-3,071	-517	-2,554	-182	-142	+174	-453	-1,951	-1,951
+1,167	-3,571	-276	-3,301	-357	-84	+179	-597	-2,442	-2,442
+488	-2,936	-311	-2,625	-194	-380	+86	-955	-1,181	-1,181
+1,372	-2,875	-77	-2,798	-139	-139	+95	-624	-1,372	-1,372
+1,694	-3,892	-1,348	-2,544	-200	-177	+100	-573	-1,694	-1,694
+1,508	-4,150	-1,941	-2,609	-258	-353	+123	-523	-1,508	-1,508
-1,657	-3,273	-507	-2,766	-248	-55	+170	-1,076	-1,657	-1,657
-1,926	-5,522	-1,034	-4,488	-302	-200	+166	-1,926	-1,926	-1,926

Source: Department of Commerce "Balance of Payments Statistical Supplement Revised Edition", and "Survey of Current Business," September 1963.

million in 1961. In 1962, they jumped to \$1,076 million, more than twice the 1961 level, and in the first half of 1963 actually amounted to \$1,026 million, almost as much as in the entire preceding year.

The relative stability of long-term capital outflows from 1956 through 1962 could be interpreted as an indication that these flows did not contribute to the deterioration of the balance of payments after 1957, at least until 1963. But such an interpretation would not be well founded. Important shifts occurred after 1956 in the geographic distribution of U.S. investments abroad. (See table 11.) These shifts generally increased the flow of funds going to reserve-accumulating countries at the expense of capital flowing to countries which returned the greater part of their dollar receipts to the United States. As a result, there was an increase in the adverse balance-of-payments impact of each dollar of international investment.

TABLE 11.—*Geographic distribution of U.S. private capital outflows*

[Millions of dollars]

	Developed Countries ¹	Less developed countries	Total
Total all types:			
1961.....	3, 114	1, 036	4, 150
1962.....	2, 721	552	3, 273
1963 (1st half) ²	1, 947	191	2, 138
Direct investments:			
1961.....	1, 145	454	1, 599
1962.....	1, 295	262	1, 557
1963 (1st half) ²	806	147	953
Other investments:			
1961.....	1, 967	585	2, 552
1962.....	1, 426	290	1, 716
1963 (1st half) ²	1, 141	44	1, 185

¹ Europe, Canada, Japan, Australia, New Zealand, South Africa, and International Bank.

² Preliminary.

Sources: "Survey of Current Business," August 1963, p. 16; and Balance of Payments Division, Office of Business Economics.

Short-term capital outflows, which were modest from 1946 through 1956 at levels generally less than \$500 million a year, jumped to \$1.3 billion in 1960 and \$1.5 billion in 1961. They abated to \$500 million in 1962, but rose again to a seasonally adjusted annual rate of \$1 billion in the first half of 1963. Transactions appearing under "errors and omissions," presumed to be largely capital movements, have exhibited even more dramatic changes in recent years. Until 1960, the United States enjoyed an inflow of funds in this category. From 1955 to 1959 this inflow fluctuated around \$500 million a year. In 1960, however, the inflow turned into a substantial outflow which increased further in 1961 and again in 1962. In the latter year, the outflow exceeded \$1 billion, a deterioration in this account, as compared with 1958 and 1959, of around \$1.5 billion. Indeed, Professor Bell has suggested that the reversal in the direction of movement of the capital component of errors and omissions may have been even larger than is indicated by the net balances reported in the account.⁷ This implies that increased receipts for noncapital items also included in the account have offset larger capital outflows.

It is clear that the deterioration of the short-term capital and errors and omissions accounts was an important factor in the overall

⁷ Philip W. Bell, "Private Capital Movements and the U.S. Balance-of-Payments Position," in Joint Economic Committee, "Factors Affecting the U.S. Balance of Payments," 1962, pp. 447-457.

balance-of-payments deficits which occurred at the same time. But a large portion of these outflows were directly associated with exports, and, to the extent that this was so, did not result in any overall balance-of-payments drain. Professor Bell has suggested that "only \$600 to \$800 million of the \$2.6 billion of recorded U.S. short-term capital outflow over the 2 years 1960-61 (excluding \$175 million in short-term loans by U.S. banks to foreign banks and officials) can be considered as having had an adverse effect on our balance-of-payments position. The rest of the outflow, probably, came directly back to the United States as payment for exports which would not have been purchased had U.S. credit not been made available."⁸

An important factor influencing changes in capital movements in recent years, in contrast to the early 1950's, was the restoration of convertibility to the major European currencies at the end of 1958. This greatly increased the international mobility of funds. American residents who wished to transfer funds abroad could now do so without fear that their capital would be blocked or subject to stringent conditions of convertibility. Foreigners, who had been heavily restricted in their freedom to shift funds abroad, now enjoyed a greater measure of freedom. Moreover, the restoration of convertibility was an important and widely recognized indication that the European currencies had regained strength and stability, and it thus weakened incentives to transfer funds out of Europe in search of safety.

The cumulative effect of investments made abroad has been to generate a return stream of income receipts which has in recent years reached impressive dimensions—\$3,850 million in 1962 alone. (See table 12.) There has been a tendency to compare the returns on international investment with annual investment outflows, and to conclude from the equivalence, or near equivalence, of the respective amounts that capital outflows have little, if any, adverse impact on the balance of payments. This line of reasoning takes into account only one of the numerous feedback effects which were enumerated above. (See pp. 21-22.) But the reasoning would be somewhat misleading even if capital outflows and income remittances were the only balance-of-payments effects of investment abroad. There can be no doubt that income remittances from abroad are an important benefit to the balance of payments. Each profitable investment returns more, over its lifetime, than is originally invested. But it takes a long period for investment returns to accumulate to the initial balance-of-payments drain resulting from the act of investment. The income returns from abroad in 1962 were only in small measure related to the capital outflows of that year. The bulk of these returns stemmed from American investments made throughout the past. If not a single dollar of new capital had flowed abroad in 1962, the income remitted from foreign investments would not have been substantially different. If U.S. investments abroad ceased or fell to low levels for a number of years, the upward trend of remitted earnings would probably be moderated. But continued growth in foreign exchange earnings from this source would still be possible because of the growth of U.S. investments abroad through reinvested earnings.

⁸ *Ibid.*, p. 464.

TABLE 12.—*Income on U.S. private investments abroad*

[Millions of dollars]

	Direct invest- ments	Other private	Total		Direct invest- ments	Other private	Total
1946.....	589	162	751	1955.....	1,912	258	2,170
1947.....	869	167	1,036	1956.....	2,171	297	2,468
1948.....	1,064	174	1,238	1957.....	2,249	363	2,612
1949.....	1,112	185	1,297	1958.....	2,121	417	2,538
1950.....	1,294	190	1,484	1959.....	2,228	466	2,694
1951.....	1,492	192	1,684	1960.....	2,355	518	2,873
1952.....	1,419	205	1,624	1961.....	2,767	697	3,464
1953.....	1,442	216	1,658	1962.....	3,050	800	3,850
1954.....	1,725	230	1,955				

Sources: Department of Commerce, "Balance of Payments Statistical Supplement Revised Edition"; and "Survey of Current Business," June 1963.

An attempt to trace the main forces resulting in the balance-of-payments deficit should not be confined to an examination of leading payments items. It is just as correct to argue that international earnings are too low as that expenses are too high. Let us turn to exports, the largest element of earnings in the balance of payments. And it will be convenient to examine imports, the largest payments item, along with exports. Available evidence suggests that the U.S. competitive position in the world economy has suffered some impairment. But whatever the changes in the U.S. competitive position in recent years, it may be argued that this position is currently unsatisfactory in the sense that the balance-of-payments problem could be eliminated through an appropriately higher degree of competitiveness which would result in an export surplus of requisite size.

While U.S. exports of all products, except transfers under military grants, remained around 17 percent of the world's total exports after 1950, U.S. exports of manufactured products, as a percentage of the manufactured products exported by the leading industrial countries, declined from 27 percent in 1950 to 21 percent in 1962. Numerous investigations have confirmed that the United States became less competitive, especially in the late 1950's. But losses in the U.S. shares of individual commodity and country markets were not as great as is suggested by the deterioration in the U.S. share of total world exports of manufactures. Unfortunately for the United States, relatively depressed conditions prevailed in markets, such as Latin America, where the U.S. share is large, while growth tended to occur in markets where the U.S. share is small. Moreover, competitive losses were not general and widespread, but tended to be concentrated on a few products, notably steel and automobiles.

Inflation in the United States has often been blamed for "pricing U.S. goods out of world markets." At first glance, this criticism appears misplaced, for the U.S. consumer price index, wholesale price index, and GNP deflator rose less sharply than comparable indexes in other leading trading countries. But a more selective examination of prices indicates that American price increases, to a greater extent than foreign, occurred on products important in international trade. Unit value indexes of manufactured exports suggest that U.S. export prices rose more rapidly than those of the other major trading countries.

TABLE 13.—Unit value indexes of manufactured exports in industrial countries, 1954-62¹

[1953=100]

Country	1954	1955	1956	1957	1958	1959	1960	1961	1962
Belgium-Luxembourg.....	94	96	98	102	98	95	95	95	(?)
Canada.....	100	102	107	108	105	107	107	103	101
France.....	99	99	104	104	102	94	99	99	99
West Germany.....	96	96	99	101	100	99	100	105	106
Italy ²	96	92	88	90	86	80	83	80	-----
Japan.....	96	91	93	97	93	93	95	91	89
Netherlands.....	97	98	101	103	101	101	101	105	105
Sweden.....	99	100	103	108	108	108	110	112	(?)
Switzerland.....	99	96	96	98	99	97	(?)	(?)	(?)
United Kingdom.....	99	101	105	108	110	110	113	114	117
United States.....	99	101	106	112	113	116	118	121	122

¹ All figures are adjusted for changes in exchange rates between the national currencies and the U.S. dollar.² Not available.

³ The index shown for Italy is one with variable weights (Paasche index) covering all of SITC secs. 5-8. The United Nations formerly used for Italy an index with fixed base-year weights (Laspeyres) which covered "highly fabricated goods other than food." The sensitivity of export unit value indexes to differences in coverage and method of weighting is well illustrated by the wide difference between these 2 indexes. In 1959, the old base-year weighted index stood at 98 (on a 1953=100 base) compared with only 80 for the new index.

NOTE.—Figures are from United Nations, Monthly Bulletin of Statistics (June 1963), p. xviii, converted to base 1953=100.

Source: Walter S. Salant et al., "The United States Balance of Payments in 1968" (Brookings Institution, Washington, D.C., 1963), p. 75.

An examination of cost changes is a useful supplement to an analysis of price changes, when evaluating shifts in the competitive positions of nations. Indeed, changes in costs are preferable to price changes as indicators of altered competitive circumstances:

That cost indices are preferable on theoretical grounds may be seen if we consider the case of two countries which export identical goods. When transportation costs are deducted, such goods must have the same price in both of the countries and also in third countries. Now, if in one country costs are stable while in the other they rise because of inflation, the price of the product in the world market will increase, but the country with rising costs will nonetheless lose a part of its share in the market to the country with stable costs. A comparison between the movements of the price of the product in the two countries, however, must show the same rise in both. It will thus give us no hint as to which country has inflated and is likely to have lost export markets, whereas a comparison of the cost levels would.⁹

Labor costs in the United States, during the early part of the postwar period, rose more rapidly than comparable costs in most other industrial countries, even though the rate of increase in hourly earnings in the United States was lower. (See table 14.) This seemingly paradoxical development is the result of faster gains in productivity (output per man-hour) in the other countries than in the United States.

⁹ Friederich A. Lutz, "International Payments and Monetary Policy in the World Today," Wicksell Lectures, 1961 (Almqvist & Wicksell: Stockholm), p. 13.

TABLE 14.—Output per man-hour, hourly earnings and labor costs in manufacturing

[1953=100]

	1953	1954	1955	1956	1957	1958	1959	1960	1961
United States:									
Output per man-hour.....	100	99	106	107	107	109	117	120	124
Hourly earnings.....	100	102	107	112	118	121	126	130	133
Labor costs.....	100	103	101	105	110	111	107	108	107
Belgium:									
Output per man-hour ¹ ..	100	109	117	122	126	127	133	139	143
Hourly earnings.....	100	103	106	115	125	131	133	138	143
Labor costs.....	100	94	91	94	99	103	100	99	100
France:									
Output per man-hour.....	100	108	115	121	133	145	149	154	165
Hourly earnings ²	100	108	116	130	137	132	119	129	139
Labor costs ²	100	100	101	107	103	91	80	84	84
Germany:									
Output per man-hour.....	100	105	112	115	122	129	138	148	152
Hourly earnings ²	100	102	109	119	129	138	145	160	184
Labor costs ²	100	97	97	103	106	107	105	108	121
Italy:									
Output per man-hour.....	100	106	115	123	130	138	152	163	167
Hourly earnings.....	100	104	109	117	123	128	131	137	147
Labor costs.....	100	98	95	95	95	93	86	84	88
Japan:									
Output per man-hour.....	100	107	113	119	128	123	150	173	197
Hourly earnings.....	100	106	109	120	126	125	136	148	162
Labor costs.....	100	100	96	100	98	102	91	85	82
United Kingdom:									
Output per man-hour.....	100	104	108	108	110	112	116	122	122
Hourly earnings.....	100	107	116	124	133	137	142	155	164
Labor costs.....	100	103	108	115	121	122	123	127	133

¹ Belgian on working hours from Institut de Recherches Economiques, Sociales et Politiques.² Adjusted for exchange-rate changes (1957-61 for France, 1961 for Germany).

Source: Bela Balassa, "Recent Developments in the Competitiveness of American Industry and Prospects for the Future," in Joint Economic Committee, "Factors Affecting the United States Balance of Payments," 1962, p. 36.

Until the late 1950's costs of industrial raw materials also rose more rapidly in the United States than elsewhere, reflecting to a large extent the rapid increase in American steel prices through 1958. (See table 15.)

TABLE 15.—Price indexes of industrial raw materials

[1953=100]

	1953	1954	1955	1956	1957	1958	1959	1960	1961
United States ¹	100	100	103	107	109	108	110	110	109
Belgium	100	98	103	104	106	96	96	101	100
France ²	100	96	98	102	102	91	84	86	89
Germany ²	100	98	103	104	106	104	103	104	108
Italy	100	98	102	109	111	102	98	99	97
Japan ¹	100	93	92	94	93	87	86	84	86
United Kingdom	100	98	101	105	106	99	100	100	99

¹ Calculated by using a method described in Cheng, Hang Sheng, "Relative Movements in the Prices of Exports of Manufactures, United States versus Other Industrial Countries," IMF staff papers, March 1962, p. 104.² Adjusted for exchange rate changes (1957-61 for France, 1961 for Germany).Source: *Ibid.*, p. 39.

In large measure, these changes in the U.S. international competitive position reflect the abnormal circumstances of many important trading countries in the immediate postwar years. The improvement in their positions is a measure of the success of American foreign policy in promoting recovery from the Second World War and in building up the strength of the free world. Some deterioration in the U.S. competitive position of 1950 was a necessary condition for these

objectives to be realized. Hal B. Lary has suggested that the balance-of-payments deficits incurred prior to the Suez crisis of 1956-57 "could scarcely be regarded, even now, as early evidence of some competitive inadequacy," in view of their important role in "enabling other countries to rebuild their monetary reserve assets and in laying the basis for the subsequent restoration of currency convertibility."¹⁰

The large gains in productivity in Europe and Japan relative to the United States are, at least in major part, a result of the rapid rebuilding of industrial capacity in these countries with the benefit of the most modern technology available, while the United States, with its industrial plant unimpaired by war, modernized and expanded its productive assets more gradually.

The substantial devaluations of the leading European currencies in 1949 also played a major role in improving the competitive positions of Europe vis-a-vis the United States. Indeed, the continuing surplus positions of these countries suggest that the devaluations, while appropriate at the time, may have been excessive over the long term.

While international competitive pressures have intensified, U.S. exports benefited from the progressive liberalization or elimination of quantitative restrictions which the European countries and Japan had imposed against imports to safeguard and build up their reserves in the early years of reconstruction. Unfortunately, a number of countries continue to maintain quantitative restrictions which were originally imposed for balance-of-payment reasons, even though such reasons are no longer applicable. These countries are impeding the solution of the U.S. balance-of-payments problem, and, if they are GATT members, may be violating their express international commitments.

The postwar behavior of imports also provides some evidence of decline in competitive position. For example, imports of finished manufactured products rose 133 percent from 1953-55 to 1960-62, while the U.S. GNP rose only 40 percent in the same period; and imports of "research intensive" products rose 226 percent from 1953-55 to 1962, while GNP increased only 48 percent.¹¹ This deterioration in competitive position is not apparent from an examination of the relationship of total imports to GNP. Imports have been a fairly stable percentage of GNP partly because declining prices for foodstuffs and raw material imports, which play a large role in American foreign trade, have offset increases in other import categories.

VIII. BALANCE-OF-PAYMENTS POLICIES OF THE UNITED STATES

Although deficits in the postwar U.S. balance of payments began in 1950 and continued every year until 1957, restoration of balance was not recognized as an important policy objective until 1959. Before that time, the U.S. deficits were not regarded with concern because they permitted other countries to rebuild their international reserves and thus contributed to the dismantling of exchange controls and quantitative restrictions, and because they were not disturbingly large.

¹⁰ Hal B. Lary, "Problems of the United States as World Trader and Banker" (National Bureau of Economic Research, 1963), p. 19.

¹¹ Hal B. Lary, Joint Economic Committee hearings on the "U.S. Balance of Payments," pt. 2, 1963, pp. 305, 307, and Joint Economic Committee, "Economic Indicators."

In 1959, however, the Government became concerned about the U.S. international payments position and began a program to restore balance. The first steps were taken in the Government's own domain, through tying of aid in 1959. During the recession which began around May 1960, Treasury and Federal Reserve policy sought to discourage capital outflows by preventing short-term interest rates from declining as much as in earlier periods of depressed business conditions. In 1960, also, the first steps were taken to reduce the balance-of-payments impact of military spending overseas. But the need for more intensified efforts became evident in a spectacular way when, in the fall of 1960, a burst of speculation on the London gold market pushed the price of gold above \$40 an ounce for a brief period and dramatized for all to see that the strength of the dollar was no longer beyond question.

The steps begun in 1959 have subsequently evolved into a broadly based, multifaceted program. In selecting its policies, the Government has been mindful of its domestic and international responsibilities, and it has declined to adopt certain measures which, although conceivably helpful to the balance of payments, could also have important undesirable consequences. The following have been expressly excluded:

1. Devaluation;
2. Deflation;
3. Exchange controls;
4. Quantitative restrictions to safeguard the balance of payments;
5. Travel restrictions; and
6. Export subsidies for other than agricultural products.

And the United States has been unwilling to withdraw from its commitments toward the less-developed countries and its military allies, although U.S. programs have been restructured, to the extent compatible with these commitments, to reduce their adverse balance-of-payments impact.

Several policies adopted or advocated primarily for domestic reasons also have important implications for the balance of payments. Two are especially noteworthy. The first is the general policy of price stability which has been pursued in a number of ways and found important new expression in the wage-price policy advocated for business and labor in the 1962 Annual Report of the Council of Economic Advisers.

This wage-price policy is intended to foster domestic price stability by establishing as a general guidepost the principle that the rate of increase in wage rates (including fringe benefits) in particular industries should be equal to the trend rate of overall productivity increase. This clearly has important implications for the U.S. international competitive position. The continuing balance-of-payments deficits and the growing urgency of controlling them have added strong reasons for assuring the policy's success.

The second policy consists of cutting taxes. To stimulate investment in the United States, an investment tax credit was enacted in 1962, and the Treasury Department revised its depreciation guidelines so as to increase the cash flow to business. The administration has now proposed that Congress enact a broadly based program of tax reduction and reform, applicable both to individuals and busi-

nesses. The administration advocates these tax measures in the expectation that they would stimulate the domestic economy, increase the rate of economic growth, reduce unemployment, and more nearly realize the full economic potential of the United States. The administration has also strongly emphasized that it relies in part upon enactment of the tax cut to improve the balance of payments. The essence of its case is that economic growth will induce foreign capital to seek investment in the United States and keep at home American funds that would otherwise have been invested abroad; that expanded output will lead to more efficient utilization of existing plant and lower costs in the short run, thereby improving the U.S. international competitive position; and that the short-run effect will be reinforced in the long run, as expanding markets stimulate research and development, modernization, and innovation. Proponents of the tax cut recognize that such a cut would also involve certain unfavorable effects, at least in the short run. Most importantly, it would result in an expansion of domestic demand for imports and for goods of the type exported, with a resulting tendency to reduce the U.S. trade surplus. And despite lower costs of production at higher levels of plant utilization, an expansion of demand is more likely to result in higher rather than lower prices. Also, increased savings, especially for high-income groups, could tend to increase capital exports. But these adverse considerations are believed by tax-cut proponents to be heavily outweighed by the anticipated favorable effects.

This volume contains two statements which examine the actual U.S. balance-of-payments experience during periods of slack and prosperity and provide some basis for judgment concerning the balance-of-payments case for the tax cut. (See pts. IV and V, pp. 105-126.)

We turn now to an enumeration of policies which have been implemented or proposed for the primary purpose of improving the balance of payments.

A. EXPORT EXPANSION

1. Enactment of the Trade Expansion Act of 1962 to enable American negotiators to broaden U.S. export markets in general, and in particular to mitigate the adverse effects on U.S. exports of tariff discrimination arising from the Common Market.
2. Expansion and improvement of the export credit facilities of the Export-Import Bank and provision of export insurance facilities through the Federal Credit Insurance Association covering both credit and political risks.
3. Intensification of the promotional work of U.S. embassies abroad through stepped-up market research, information services, and representational activities.
4. Establishment of overseas trade centers.
5. Increases in the number and activity of U.S. trade missions abroad.
6. Increased U.S. participation in trade fairs abroad.
7. Establishment of the position of National Export Expansion Coordinator in the Department of Commerce, and 34 regional export expansion councils to increase American industry's interest in serving foreign markets.

8. Improvement of the Agriculture Department's cotton auction procedures to ensure competitive pricing for U.S. cotton in foreign markets, and other measures to promote agricultural exports.

9. Elimination of unjustifiable differentials between inbound and outbound ocean freight rates applicable to comparable products traveling the same trade routes. And elimination of unjustifiable ocean freight rate advantages to foreign suppliers competing with American exporters in third country markets.

10. Exertion of pressures on other countries in GATT, the OECD, and elsewhere to eliminate nontariff barriers against U.S. exports.

B. TOURISM

1. Establishment of the U.S. Travel Office in the Department of Commerce to promote travel to the United States.

2. Implementation of a "See America Now" program to encourage Americans to vacation at home and induce foreigners to visit the United States.

3. Exertion of diplomatic pressure on other countries for the removal of their remaining restrictions on tourism.

4. Reduction of the duty-free allowance for returning travelers from \$500 to \$100.

C. FEDERAL EXPENDITURES ABROAD

a. Economic assistance programs (subject to exception only under rigidly restricted circumstances)

1. Tying of loan-financed commodity procurement exclusively to the United States.

2. Prohibition of grant-financed commodity procurement in 19 industrial countries, mainly in Europe and Japan, to reduce the flow of aid funds into the reserves of the surplus countries.

3. Restriction of dollar transfers to purchases in the United States through the use of such techniques as segregated accounts and irrevocable letters of credit.

4. Discontinued financing of commodities of which the United States is a net importer.

b. Military

1. Increased procurement of goods in the United States for use overseas through the general requirement that purchases be made in the United States if the cost, including transportation and handling, is not more than 50 percent higher than the comparable foreign cost.

2. Reduced procurement abroad of goods for use in the United States by requiring that the Secretary of Defense review each case where application of the relevant regulations (the Buy America Act and Executive Order 10582) would normally result in purchase abroad.

3. Review and reduction of overseas construction programs.

4. Review of the balance-of-payments effect of using foreign nationals as employees at U.S. overseas military installations.

5. Development of means to reduce expenditures abroad for contractual services.

6. Review of expenditures abroad associated with the military assistance program.

7. Rotation of certain deployed air units without dependents.

8. Encouragement of voluntary savings programs by American personnel abroad.

9. Changes in the pricing and procurement policies of overseas PX's and commissaries to encourage purchases in these facilities instead of on the local foreign economies concerned.

10. Increased military receipts through offset agreements, such as with Germany and Italy, for countries to increase their military procurement in the United States.

11. Development of means for expanding credit sales of U.S. military supplies and services to facilitate the negotiation of offset agreements with other countries.

c. Other

Implementation of the "Gold Budget Review" by the Bureau of the Budget to screen and reduce the expenditures abroad of Federal departments and agencies.

D. CAPITAL FLOWS

1. Elimination of the right of Americans to own gold abroad.

2. Elimination, in the Revenue Act of 1962, of incentives to abuse foreign "tax havens" as a means of tax avoidance.

3. Efforts by the Federal Reserve and Treasury to keep short-term interest rates high enough to discourage short-term capital outflows, without placing upward pressure on long-term rates and thereby damping economic growth.

4. Recommendation by the President that Congress enact an interest-equalization tax, in effect a tariff on imports of certain foreign securities, to help equalize the costs here and abroad of longer term foreign borrowing.

5. Exemption of official foreign time deposits from interest rate ceilings applicable to domestic accounts.

6. Increase in interest rate ceilings applicable to time deposits in with commercial banks and certificates of deposit maturing in 90 days to 1 year.

7. Application of pressures for the reduction or elimination by foreign countries of their restrictions on capital outflows.

8. Establishment of a Government-financial community committee, headed by Henry H. Fowler, Under Secretary of the Treasury, to market securities of U.S. private companies to foreign investors and increase the availability of foreign financing for U.S. business operating abroad.

9. Encouragement of foreign investments in the United States through the establishment of an Office of International Investment in the Department of Commerce to work together with the Area Redevelopment Administration.

10. Intervention by the Treasury stabilization fund in forward exchange markets to reduce incentives for short-term capital exports.

E. SPECIAL MEASURES TO FINANCE THE DEFICIT

1. Negotiation of advance repayments of debts owed to the United States.

2. Sales to foreign monetary authorities or governments of non-marketable medium-term Treasury bonds denominated either in dollars or in their own currencies.

F. COOPERATIVE POLICIES WITH OTHER COUNTRIES

1. U.S. initiative and support for enlargement of IMF quotas.
2. Participation in the "group of 10" supplementary IMF borrowing arrangement, under which the 10 countries agree under certain circumstances to lend the IMF up to \$6 billion to increase its holdings of convertible currencies.
3. Participation in a gold pool arrangement with the leading European countries to stabilize gold prices on the London market and thereby maintain confidence in the smooth functioning of the international monetary system.
4. Discussion and coordination of domestic and international economic policies through the monthly meetings of Working Party 3 of the OECD's Economic Policy Committee.
5. Conclusion by the Federal Reserve of swap arrangements with other countries, providing for the exchange of dollars for equivalent amounts of foreign currency, to provide the United States with means for conducting stabilization operations in foreign exchange markets and, more generally, for preventing disruptive movements of short-term funds and a depletion of U.S. gold reserves. At the end of October 1963, the United States had arranged swaps totaling \$1.95 billion.
6. Conclusion of a \$500 million standby arrangement with the IMF to be drawn upon as necessary to permit continued IMF repurchases in dollars.
7. U.S. participation through an observer at the monthly meetings of central bankers at the Bank for International Settlements at Basle.
8. Annual Cabinet-level discussions with Canada and Japan on economic problems of mutual concern.

IX. THE POLICIES OF OTHER COUNTRIES

International monetary cooperation has evolved to a high level never before attained among nations. The situation today is a far cry from the chaos that existed during the interwar period. Yet aspirations have moved forward with accomplishments, and further progress appears necessary.

The situation of deficit and surplus countries is inherently unsymmetrical because the former must sooner or later exhaust their reserves and capacity to borrow while the latter have no comparable limit on their ability to absorb reserves. The situation of a deficit country which also manages a reserve currency is especially difficult, because such a country's freedom of action is more narrowly constrained than that of other countries. The United States, for example, has ruled out devaluation as a solution to its problem because such a move could impair the future status of the dollar as a store of international value and might result in the collapse of the present international monetary order. On the other hand, most of the surplus countries devalued substantially in the postwar years. France alone devalued its currency 22 percent in 1949, 17 percent in 1957, and again 15 percent in 1958. Table 16 shows the extent to which exchange rate relationships have altered, to the detriment of the United States.

TABLE 16.—*Indexes of foreign exchange rates (1938=100)*¹

[Average national currency prices in dollars, as percentages of their 1938 prices, expressed as index numbers]

	Germany	Italy	France	Norway	Sweden	Denmark	Netherlands	United Kingdom	Belgium	Switzerland	Austria	Canada	Japan
1921.....	3	81	256	61	91	81	61	79	222	76	(2)	90	169
1926.....	59	74	112	91	106	120	73	99	100	85	75	101	167
1929.....	59	99	137	109	106	122	73	99	83	84	74	100	161
1938.....	100	100	100	100	100	100	100	100	100	100	100	100	100
1941.....	100	96	(2)	(2)	94	(2)	(2)	83	(2)	101	(2)	92	83
1947.....	75	7	29	82	110	95	68	83	68	102	54	101	(3)
1948.....	75	3	17	82	110	95	68	83	68	102	54	101	(3)
1949.....	70	3	16	75	101	88	63	75	65	102	49	98	1
1950.....	60	3	10	57	77	66	48	57	59	101	25	92	1
1951.....	60	3	10	57	77	66	48	57	59	101	25	95	1
1952.....	60	3	10	57	77	66	48	57	59	101	25	103	1
1953.....	60	3	10	57	77	66	48	57	59	102	20	102	1
1954.....	60	3	10	57	77	66	48	57	59	102	20	103	1
1955.....	59	3	10	57	77	66	48	57	59	102	20	102	1
1956.....	59	3	10	57	77	66	48	57	59	102	20	102	1
1957.....	59	3	10	57	77	66	48	57	59	102	20	105	1
1958.....	60	3	10	57	77	66	48	57	59	102	20	104	1
1959.....	60	3	7	57	77	66	48	57	59	101	20	105	1
1960.....	60	3	7	57	77	66	48	57	60	101	20	104	1
1961.....	62	3	7	57	77	66	50	57	60	101	20	99	1
1962.....	62	3	7	57	77	66	51	57	60	101	20	94	1

¹ In 1948, Germany converted 10 reichsmarks for 1 German mark; and France, in 1960, exchanged 100 old francs for 1 new franc. The data shown in the table are adjusted for these changes so as to provide consistency with the base year.

² Not available.

³ Official rates—free rates: 1941=88, 1947=93, 1948=93, 1949=93, and 1950=92.

⁴ Multiple rate system with no predominant rate.

⁵ Official rates—free rates: 1948=11, 1949=10, 1957=8, and 1958=8.

⁶ Official rates—bank notes accounts: 1949=63, 1950=58, and 1951=58.

Sources: Board of Governors of the Federal Reserve System, "Banking and Monetary Statistics," "Supplement to Banking and Monetary Statistics," and "Federal Reserve Bulletin," various issues. Robert Triffin, "Europe and the Money Muddle," (New Haven: Yale University Press, 1957), p. 323.

Officials seldom question the appropriateness of present exchange rate relationships, at least in public. This is scarcely surprising, for, aside from any advantages which some countries might perceive in their existing rates, the authorities fear the speculative capital movements which could be triggered by uncertainty as to the stability of exchange relationships. The appreciation in 1961 of the German mark and Netherlands guilder was accompanied by destabilizing speculation on a substantial scale, and drove home the lesson that changes in the par values of leading currencies, even nonreserve currencies, nowadays take place in an atmosphere that is difficult to control.

While recognizing these difficulties, it is also pertinent to observe that the German and Netherlands revaluations, for all of the attendant disruptions, were successfully implemented. Perhaps exchange rate adjustments for non-reserve-currency countries merit more consideration than they have received.

The initial par values adopted under the Articles of Agreement of the International Monetary Fund in December 1946 were, for most countries, the exchange rates existing at the time. It would have been surprising if these rates were equilibrium rates after a major war which changed international trading patterns, debtor-creditor relationships, and cost-price relationships. But the currency revaluations of 1949 were of major dimensions. Most of the European currencies devalued by 30.5 percent. France and Austria devalued several times since the end of the war. Switzerland is the only European country which has not devalued in the postwar period. Given the profound structural changes which have taken place in the world in the last 15 years, it is at least arguable that the continued balance-of-payments surpluses of the European countries result from an undervaluation of their currencies in today's circumstances. Germany and the Netherlands recognized this when they appreciated their currencies 5 percent in 1961. But this change was small in relation to their 1949 devaluations of 20.6 and 30.2 percent, respectively.

In its efforts to restore equilibrium to the balance of payments in the context of existing exchange rate relationships, the United States is handicapped by certain policies of other countries. Some of these policies are enumerated below:

1. Quantitative restrictions on imports

Many of the quantitative restrictions (QR's), i.e., quotas, prohibitions, import licensing systems, now in existence were originally adopted for balance-of-payments reasons. But when the balance-of-payments justification disappeared a substantial number remained. Contracting Parties (CP's) to the GATT are permitted to maintain QR's for certain reasons unrelated to the condition of their balance of payments, subject to carefully specified conditions. Therefore, the continued use of QR's by CP's to whom the GATT balance-of-payments justification is no longer applicable need not be inconsistent with the GATT.

CP's who originally justified QR's on balance-of-payments grounds and who no longer do so include Austria, Belgium, Luxembourg, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, and the United Kingdom. Some of the remaining QR's may be in-

consistent with their international commitments under the GATT. However, it is difficult to sort out those QR's which are consistent with the GATT and those which are not.

As nearly complete a list of the remaining QR's in use by these and certain other countries as it has been possible to obtain is shown in this volume as an appendix. (See pp. 129-164.)

Most of the products affected by these QR's are agricultural, and the problem they pose for the United States is only a part of the more general problem of agriculture in world trade. The United States also maintains numerous QR's on agricultural imports, but received a GATT waiver in 1955 of its obligations insofar as these might be inconsistent with action under section 22 of the Agricultural Adjustment Act, as amended. While some other countries have received waivers for particular circumstances, usually of a temporary nature, none is as broad as that granted to the United States. In addition to its QR's on agricultural products, the United States maintains such restrictions on petroleum and lead and zinc.

2. The Common Market agricultural policy

The common agricultural policy (CAP) of the EEC, which is to replace the different national systems of agricultural support in the constituent states, threatens seriously to impede American agricultural exports to the EEC. In 1961, such exports were nearly \$1.2 billion. It is too early to know the exact form the CAP will take, but indications are that the EEC members will generally strive for high internal support price levels, with the probable result that internal production will expand and shut out or severely limit imports. The United States has a strong balance-of-payments interest in seeing the CAP develop along liberal, rather than protective lines.

3. Capital market controls by the surplus countries

The surplus European countries have been channeling national savings into gold and dollar reserves while at the same time large amounts of capital were obtained from the United States. This paradoxical situation is detrimental to the U.S. balance of payments. Most European countries maintain controls to limit foreign borrowing in their capital markets. In addition, certain structural and institutional conditions impede the flow of savings directly into productive investments within their own countries. Both factors swell the demand for U.S. funds.

Progress has been made in achieving liberalization of the capital controls of other countries. Codes of liberalization, negotiated within the OEEC and revised when the United States joined the OECD, have codified the progress to date. Many restrictions remain, however.

In response to a request from the Joint Economic Committee, the Treasury Department presented a summary of the controls over capital movements exercised by major industrial countries. This summary, which was made a part of the committee's printed record of the July 8 and 9, 1963, hearings on the U.S. balance of payments, is reproduced on pages 42 and 43.

Summary of controls over capital movements exercised by major industrial countries

Country	Type of capital movement				
	Convertibility of currency on capital account	Direct investments abroad	Portfolio investment abroad	Commercial credits—5 years and under	Financial loans
Belgium-Luxembourg	External	Control via free market	Control via free market	Control via free market	Control via free market.
France	do.	Liberalized	Free	Liberalized	Individual licensing and banking laws.
Germany	Full	Free	do.	Free	Free.
Italy	External	Largely liberalized	Generally permitted, with some exceptions.	Credits up to 5 years liberalized, all other credits under 1 year liberalized.	Loans within the EEC under 5 years less than \$80,000, and with interest less than 6 percent are free. Loans over 1 year liberalized.
Netherlands	do.	Liberalized	Control via free market	Liberalized	Individual licensing.
Switzerland	Full	Large credits controlled under bank laws.	Large credits controlled under banking laws.	Large credits controlled under banking laws.	Large loans controlled under banking laws.
United Kingdom	External	Individual licensing and control via free market.	Control via free market	Controlled over 6 months	Controlled under both banking and exchange control laws.

Country	Type of capital movement				
	Deposits in foreign banks	Flotation of securities issues by nonresidents	Repatriation of direct investments by nonresidents	Repatriation of portfolio investments by nonresidents	Areas where special regulations apply ¹
Belgium-Luxembourg...	Control via free market.	Banking laws and free market exchange rate.	Control via free market.....	Control via free market.....	None.
France.....	Generally not permitted.	Controlled under both banking and exchange control laws.	Liberalized.....	Free.....	French franc area.
Germany.....	Free.....	Free.....	Free.....	do.....	None.
Italy.....	Generally not permitted.	Controlled under both banking and exchange control laws.	Liberalized.....	Liberalized.....	OECD; EEC.
Netherlands.....	do.....	do.....	do.....	Control via free market.....	Guilder area.
Switzerland.....	Free.....	Controlled under banking laws.	Free.....	Free.....	None.
United Kingdom.....	Generally not permitted.	Controlled under both banking and exchange control laws.	Free on approved investments.	Control via free market.....	Sterling area Uniscan.

¹ Payments to bilateral account countries not listed here are also under special controls.

NOTE.—The notation "liberalized" indicates that prior authorization is required, but is freely given. The notation "control via free market" indicates that transactions are permitted, but that the call on foreign exchange to finance them is restricted by chan-

neling them through a free market, the supply of foreign exchange to which is limited. Tendencies for outflow to increase result in changes in the free market exchange rate rather than in an increased outflow of foreign exchange.

Source: Treasury Department.

LONDON CAPITAL MARKET

The United Kingdom capital market is one of the oldest and best developed in the world. Before World War II it was a major supplier of capital for the world, and the pound sterling was the most widely held reserve currency. During most of the postwar period there was not a sufficient volume of capital generated within the United Kingdom economy to meet domestic requirements plus the amounts which all oversea borrowers would have wished to obtain. Consequently, access to the market has been limited to resident and Commonwealth borrowers, and even these have been regulated in an attempt to prevent excessive demand.

Transactions in foreign currency denominated securities are controlled by exchange regulations administered by the Bank of England for the United Kingdom Treasury. Residents who acquire certain foreign currencies (including U.S. dollars) as a result of capital transactions may, with permission, use them for the purchase abroad of marketable foreign currency securities. Otherwise they must offer them for sale to an authorized bank. Thus there is only a limited supply of foreign currencies available to British residents for foreign investment and the amount is controlled by the authorities. Individual residents, who wish to invest abroad in the specified currencies, may bid for them in this restricted market where the rate is generally above the commercial sterling-dollar rate.

This year there have been several developments which may lead to increased use of the London capital market by foreigners. A 5-percent 3-year loan for \$20 million was made to Belgium; this was the first foreign currency loan in London since the war. In later actions, a British investment trust was allowed to borrow \$10 million in New York, and the market was opened to all EFTA countries.

GERMAN CAPITAL MARKET

The German Government does not impose exchange restrictions on movements of capital into and out of Germany and occasionally a foreign issue is floated on the German market. On a net basis, however, Germany tends to be a borrower rather than a lender because of the high bond rate which currently averages roughly 6 percent. One of the prime causes of the relative scarcity of funds for industrial investment, which is reflected in the high bond rate, is a housing boom which, spurred by government concessions and subsidies, drains off into housing a large part of the savings available. Mortgage and communal bonds comprise as much as 70 percent of the total bonds issued in the German market.

The thinness of the market impedes the development of efficient institutions, limits competition, and contributes to high issue costs. The small volume of securities in circulation which contributes to this thinness is the result of several factors. The outstanding debt of the Federal, State, and municipal governments is relatively small and therefore the large refunding operations which are undertaken in countries like the United States are unnecessary in Germany. A 2½ percent tax on the issue of debt certificates as well as administrative obstacles to the placing of shares through the German stock exchanges, such as listing requirements, are additional factors which reduce the volume of securities in circulation.

FRENCH CAPITAL MARKET

Foreign companies wishing to issue securities in France must comply with the regulations governing all issues of securities and also with the exchange regulations.

Canvassing in connection with operations on securities issued by foreign companies without the guarantee of the governments concerned is prohibited under a decree of August 8, 1935. The latter limits possibilities of selling foreign shares and bonds, whether new or old issues.

No foreign securities from outside the franc zone have been offered in France since World War II.

The French capital market is underdeveloped in relation to other European capital markets. It is characterized by controls and timetables for issuing new flotations. Interest rates and issuing expenses are high. The supply of funds does not normally meet the existing demand, although in recent years the volume of total savings has been increasing.

In June 1963, the committee of experts which had been set up by the French Government in June 1962, to examine the functioning of the capital market in

France and to suggest possible methods to improve it, submitted its report. The main improvements advocated by the committee were the introduction in France of open-end investment trusts and the issue of so-called participating bonds, the yield of which would be in part fixed, in part fluctuating with turnover or profits. It proposed also that measures should be taken to facilitate the issue of convertible bonds. In recent years a number of French enterprises have been rather reluctant to make new issues on the share market, as large shareholders have been afraid of diluting their control. For this reason the committee also suggested issues of preferred shares, which until now have been forbidden in France. In commenting on the report, the Minister of Finance declared that the Government had not yet decided which of the various suggestions it would accept.

Since February 1962, French residents may freely acquire foreign securities listed on a recognized stock exchange, but the portfolio must be deposited with an authorized French bank. Direct foreign investment is subject to Finance Ministry approval, but such approval is considered only a formality.

The total absence of foreign securities issues in France since World War II, in addition to the unfavorable factors mentioned above, may also be due to the desire to insure that the market will meet French domestic requirements. Whether the French market is opened to foreign issues will depend primarily on an improvement in borrowing conditions on the market and also on a change in the attitude of the authorities. If the French balance of payments continues in a surplus condition, there may be some possibility of liberalization of the French capital market.

ITALIAN CAPITAL MARKET

In July 1961, the Italian authorities permitted the first flotation on the Italian market by a non-Italian issuer in more than 25 years. Since that time a total of four issues have been allowed, each for \$24 million, to the International Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, and the European Coal and Steel Community. Actually these issues were not too well received in the market since they offered only 5 percent when the rate on Italian Government securities was 5½ percent.

All loans to foreigners, as well as the issue of foreign securities on the Italian market, are still subject to official approval. Two April 1963 exchange office rulings now permit Italian residents to grant loans freely (within the EEC), providing that the repayment period does not exceed 5 years, nor the amount 5 million lire (\$80,000), and to buy foreign securities issued or payable abroad and listed on foreign exchanges. These decisions will help to bring the Italian capital market into closer contact with those of other countries.

In July the city of Milan offered a \$20 million bond issue in New York. This action on the part of a leading Italian city is probably due to a combination of two factors: the thinness and high cost of borrowing in the Italian capital market, and the lower cost and readier availability of the funds in New York.

Furthermore, Government tax policies have tended to make it worth while for investors to try to export capital. This has been done by smuggling banknotes into neighboring countries thus making the Italian capital market a much smaller one than basic Italian resources would otherwise support. Recent reports indicate greater attempts on the part of the authorities to halt the smuggling traffic so that future trends on this are uncertain.

SWISS CAPITAL MARKET

The Swiss capital market is second only to New York in the amount of new foreign bond issues floated since World War II. Although the Swiss market has been and will continue to be a good source of capital for international borrowers, the volume of funds available has varied and will vary from year to year depending mainly on the Swiss balance of payments and domestic needs for capital.

The large increase in capital issues in the last 2 years has been in part a response to the large volume of capital inflow in that period which was related to various political and economic crises around the world. The national bank, as part of its anti-inflationary policy, opened the market to foreign borrowers, particularly in 1961, to relieve the pressure on the domestic economy. As a matter of policy the bank carefully controls the volume of new foreign bond issues with a view to preserving the major share of available funds for Swiss borrowers and to prevent a rise in the traditionally low interest rates which for political reasons must be kept low. Approval of the national bank is required, under Swiss banking

law, for all foreign loans, purchases of shares of foreign companies, and investments abroad amounting to Swiss francs 10 million (\$2.3 million) or more that have terms of 1 year or longer.

As a matter of policy the national bank is in principle prepared, under normal circumstances, to export any balance-of-payments surplus accruing to Switzerland. As long as the balance of payments is in substantial surplus it can be expected that the Swiss National Bank will take a liberal attitude toward capital exports. The current account in the balance of payments is presently in deficit but the continued large inflow of capital which more than offsets that deficit has permitted the national bank to continue its liberal attitude toward capital exports. The bank feels that the capital market should be kept as free as possible subject to domestic needs for capital and the balance-of-payments situation.

NETHERLANDS CAPITAL MARKET

Issues on the Dutch capital market offered by Dutch and foreign enterprises must be cleared with the Netherlands Bank. The Netherlands market was closed to foreign flotations from 1955 until May 1, 1961, primarily because of the domestic need for capital and the tightness of money. In April 1961 the Netherlands Bank announced it would begin to grant licenses for foreign issues, at least for foreign bonds, on the Dutch capital market. The bank's announcement emphasized that licenses would be granted only on a limited and gradual scale. The foreign issues in 1961 totaled \$149 million and \$63 million in 1962. This foreign borrowing largely took the place of Netherlands Government issues which would have absorbed excess domestic liquidity. The primary purpose of the authorities in granting permission for these foreign issues appears to have been the maintenance of a given level of Dutch international reserves. Thus the availability of the Dutch capital market to foreigners appears to depend upon trends in the Netherlands international balance of payments.

4. *Restrictions on tourism by foreign countries*

A number of countries continue to restrict foreign exchange available for foreign travel. Table 17 on page 48, prepared by the Treasury Department and originally printed in the Joint Economic Committee hearings mentioned above, summarizes the practices of various countries. Of the countries listed, Norway and Japan appear to have the most restrictive regulations. Norway imposes a fairly low allowance of \$550 per year, of which \$50 cannot be spent except on Norwegian carriers. Japan provides no automatic travel allowance.

Most countries which place limits on the amount of foreign exchange permitted travelers provide additional amounts on justification. This procedure has generally been accepted by the IMF as meeting the requirements of Article VIII, which provides for the avoidance of restrictions on current payments. In most cases, the practice is to give additional amounts on request. But in some instances, the availability of additional foreign exchange is not well publicized, and may therefore not be known to potential travelers. In such cases, foreign travel may be discouraged.

Countries maintaining restrictions on capital exports argue that limitations on foreign exchange for travel are necessary to prevent evasion of their capital controls. The further liberalization of capital controls would diminish this justification for travel restrictions.

TABLE 17.—Foreign travel allowances granted to their residents by various countries

	Amount of allowance that traveler can convert before departure from his country	Additional amount of allowance in form of bank notes which traveler can take abroad and convert
Austria.....	\$577 per journey ¹	\$385
Belgium.....	Unlimited.....	(²)
Denmark.....	Any reasonable amount.....	290
France.....	\$700 per journey ¹	150
Germany.....	Unlimited.....	(²)
Ireland.....	\$706 per journey ¹	³ 140
Italy.....	Unlimited.....	80
Luxembourg.....	do.....	(²)
Netherlands.....	\$1,194 per journey ⁴	
Norway.....	\$500 per year.....	³ 50
Portugal.....	Unlimited.....	(²)
Spain.....	\$500 per journey ¹	50
Sweden.....	\$1,166 per journey.....	
Switzerland.....	Unlimited.....	(²)
United Kingdom.....	\$706 per journey ¹	140
Canada.....	Unlimited.....	(²)
Japan.....	No automatic allowance ⁵	

¹ Additional amounts may be allowed upon justification.

² Unlimited.

³ May be spent only on carriers of traveler's country.

⁴ An additional amount of \$40 is also granted automatically for each day of travel beyond 14 days, up to \$3,781. Unlimited additional amounts are granted on request.

⁵ Japanese declaring themselves as "business travelers" are allowed \$500 per year plus fares.

NOTE.—For countries in the above table where the allowance is not "unlimited," the allowance is general in addition to fares.

Source: Letter to Senator Jacob K. Javits from John C. Bullitt, Assistant Secretary of the Treasury, printed in Joint Economic Committee, "Hearings on the United States Balance of Payments," pt. 1, 1963, p. 62.

5. Export subsidies

A number of countries subsidize exports, thereby placing the United States at a competitive disadvantage and impairing its export earnings.

Ireland and Japan allow the partial or total exemption from corporate income taxes of certain export profits. In a treaty of commerce and navigation concluded between Japan and the United Kingdom late in 1962, Japan agreed to do away with this subsidy.

Australia and New Zealand permit exporters, in computing their income taxes, to deduct from taxable income \$2 and \$1.50, respectively, for each dollar spent in promoting export sales. Australia further permits rebates of payroll taxes in relation to increased foreign exchange earnings from exports, patents, trademarks, designs, and copyrights.

France and Japan permit accelerated depreciation for exporters meeting certain standards, the degree of acceleration depending on export performance. Greece allows exporters more favorable interest rates than are available to other borrowers.

The GATT is generally opposed to export subsidies. Article XVI:B:2 states:

The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance to their normal commercial interests, and may hinder the achievement of the objectives of this agreement.

Article XVI further states that "contracting parties should seek to avoid the use of subsidies on the export of primary products," but that if such subsidies are nonetheless used, they should not "result

in obtaining for the subsidizing country more than an equitable share of the world export trade in the product concerned." In the case of other-than-primary products, subsidies are prohibited under a declaration which became effective in November 1962 if they result in a lower export price than domestic price for the same product. Moreover, GATT imposes certain reporting requirements on countries with subsidies.

6. The remission on exports of direct and indirect taxes

This area is closely related to the above discussion of subsidies. The remission of indirect taxes, such as sales and excise taxes, on exports is not regarded as subsidization, even though it results in lower export than domestic prices. Countries generally remit indirect taxes on exports, and apply to imports indirect taxes intended to be equivalent to those levied on domestically produced goods. The underlying assumption is that indirect taxes are fully passed on to buyers, or in other words, result in prices which exceed by the full amount of such taxes the price level that would exist in the absence of the taxes. On this assumption, unless indirect taxes were remitted on foreign sales, exporters would be placed at a competitive disadvantage in the markets of importing countries relative to domestic sellers in those markets and relative to competitors from other exporting countries with lower indirect taxes.

On the other hand, direct taxes, such as corporate income taxes, are not generally remitted on exports, and there is little doubt that any such remission would be regarded as a subsidy within the meaning of GATT. The underlying assumption here is that direct taxes are not passed on to buyers and that a remission of such taxes on exports is therefore unnecessary to preserve a country's competitive position.

The United States, to a much greater extent than most European countries, emphasizes direct rather than indirect taxes. If the assumptions underlying the different treatment of exports under the two types of taxes proved false, existing practice would place the United States at a serious competitive disadvantage relative to foreign sellers. Suppose, for example, that direct and indirect taxes were both reflected in higher prices. Under such circumstances, American exports to, say, Britain, with a high U.S. tax component in their prices, would be subject, in addition to any applicable tariffs, to British indirect taxes designed to equalize the treatment of imports and domestically produced British goods; and they would have to compete, with little or no benefit from U.S. tax remittances, with continental European goods enjoying tax rebates which range generally from 10 to 25 percent of tax-free prices.

There are reasons to question the validity of the underlying assumptions that indirect taxes are passed on to consumers while direct taxes are not. Studies are now underway within the U.S. Government to determine whether, and to what extent, the U.S. competitive position is impaired by existing practices in this area.

7. *Discrimination against U.S. exports for balance-of-payments reasons by members of regional economic groups*

When the Latin American Free Trade Association (LAFTA) was formed, its members exempted imports from each other from the application of restrictions imposed to conserve foreign exchange, but maintained such restrictions on imports from outside the new association. As a result, U.S. exports, particularly of sulfur, were adversely affected.

This discrimination by the LAFTA countries is counterproductive from the point of view of improving their balance-of-payments positions—the consideration that led to the adoption of the restrictions in the first place. Presumably the LAFTA countries bought in the United States before their association because U.S. products were cheaper or available on better terms than the comparable goods of other LAFTA countries. Since the LAFTA countries use dollars to settle transactions with each other, the diversion of purchases from the United States to other LAFTA countries probably requires an even greater expenditure of dollars than was necessary before.

Despite acknowledgment that their discrimination in the application of balance-of-payments restrictions is detrimental to their international payments positions, the LAFTA countries have declined to change their practice. The contribution of such restrictions to greater political and economic cohesiveness is cited as an overriding merit of the discriminatory system.

8. *Sharing the burdens of economic assistance and military defense*

U.S. expenditures abroad for economic assistance and military programs contribute to the balance-of-payments deficit, and have been higher in relation to GNP than the contributions of other countries. A greater effort by the allied countries would not only be equitable, but would improve the U.S. balance of payments and strengthen the international payments system. Expanded and untied aid expenditures by the surplus countries would result in an expansion of U.S. exports as the recipient countries generally enlarged their purchases. Unfortunately, most of the surplus countries tie or otherwise assure that their contributions take the form of their own goods and services, even though, unlike the United States, they lack balance-of-payments reasons for doing so.

Enlarged military spending by allied countries would benefit the balance of payments by leading to greater U.S. exports of military and related products and by possibly permitting the United States to make some reductions in its military payments overseas. Moreover, diversion of foreign manpower into military uses could lead to increased demands for the goods and services of outside countries, including those of the United States.

TABLE 18.—*Economic assistance and defense expenditures of selected countries,¹ as percentages of GNP² in calendar 1961*

Countries	Percentages of GNP ³					Per capita aid and defense expenditures (6)	Per capita GNP ⁴ (7)
	Grants and Grant-like contributions	Official net lending	Total official aid (1)+(2)	Defense expenditures	Total net official aid and defense expenditures (3)+(4)		
	(1)	(2)	(3)	(4)	(5)		
Belgium.....	0.93	-0.01	0.92	3.40	4.32	\$54	\$1,254
Canada.....	.20	-.01	.19	5.32	5.51	97	1,753
France.....	1.68	.14	1.82	7.41	9.53	108	1,138
Germany.....	.25	.61	.86	4.93	5.79	72	1,235
Italy.....	.16	.07	.23	4.04	4.27	26	599
Japan.....	.20	.38	.58	1.26	1.84	8	426
Netherlands.....	.63	-.01	.62	5.03	5.65	54	950
Portugal.....	.51	.92	1.44	7.84	9.28	22	237
United Kingdom.....	.38	.30	.67	7.60	8.27	104	1,252
Weighted average, above countries ⁵.....	.54	.28	.81	5.42	6.23	56	904
United States.....	.60	.12	.72	10.36	11.08	288	2,597
Weighted average, all selected countries ⁵.....	.57	.18	.75	8.41	9.16	137	1,493
U.S. expenditure as percent of total expenditures of the selected countries.....	62.97	39.45	57.35	74.53	73.14	-----	-----

¹ The selected countries comprised the membership of the OECD'S Development Assistance Committee in 1961.

² GNP is measured at factor cost, and equals GNP at market prices less indirect taxes net of subsidies.

³ Includes grants, reparations, transfers of resources for recipients' currencies, and grant and capital contributions to multilateral agencies.

⁴ Includes bilateral loans, consolidation credits, and purchases of IBRD bonds, loans, and participations. Excludes official loans for 5 years and less.

⁵ Weights are GNP for columns (1) through (5), and population for columns (6) and (7).

Sources: "Outlook for United States Balance of Payments," hearings before Joint Economic Committee's Subcommittee on International Exchange and Payments, 87th Cong., 2d sess., December 1962, p. 71; and Statistics and Reports Division, Agency for International Development.

TABLE 19.—*Defense expenditures of NATO countries, as percentage of GNP at current market prices, calendar year 1962*

Belgium.....	3.4	Netherlands.....	5.0
Denmark.....	3.5	Norway.....	4.2
France.....	7.4	Portugal.....	8.8
Germany.....	5.7	Turkey.....	6.1
Greece.....	5.1	United Kingdom.....	7.2
Italy.....	4.0	Canada.....	5.3
Luxembourg.....	1.6	United States.....	10.7

Source: Pt. III of this volume, p. 85.

Tables 18 and 19 show the relative contributions to defense and economic assistance of the United States and other countries. With respect to aid, the U.S. contribution as a percentage of GNP was surpassed in 1961 by that of Belgium, France, Germany, and Portugal. On the other hand, the Canadian contribution was especially low, both as a percentage of GNP and in relation to Canada's per capita GNP. Also extremely low was the Italian contribution.

In military programs, the U.S. relative effort was higher than any other in the NATO group, amounting to 11.1 percent in 1961 and 10.7 percent in 1962. At the other extreme, the Japanese military effort has been exceptionally low. When aid and military programs are combined, the U.S. relative share is higher than that of any other

country. In its statement on military strategy and the balance of payments, part III, p. 84, of this volume, the Defense Department noted that "our NATO Allies have consistently fallen short of stated military force level requirements."

9. *Cooperation in international monetary affairs*

International monetary cooperation has reached high levels, but it has not been equally forthcoming from all quarters, and could, in some respects, be improved upon. It rests on more than goodwill. All the world's central bankers have seen David Low's famous cartoon of 1934 showing France, Britain, and the United States sitting aloof in the prow of a small boat, named "World Money Problem," in stormy waters, with its stern flooding and sinking despite feverish bailing by a group labeled "middle Europe." The caption was "Phew! That's a nasty leak. Thank goodness it's not our end of the boat."

(a) *The Treasury's new nonmarketable foreign currency series bonds*

In October 1962, the U.S. Treasury introduced a new type of bond to help finance the deficit. The new instrument is of fairly short maturity—ranging from 15 months to 2 years—pays interest at rates not in excess of prevailing yields on U.S. marketable bonds with comparable maturities on the date of issue, is nontransferable, and is denominated in the foreign currency of the lending country. To the foreign lender such bonds provide an investment alternative to gold or dollars with the added attraction of an exchange guarantee because it is repayable in the lender's currency.

As of the end of September 1963, five European nations had bought \$705 million of such bonds as follows: Austria, \$25 million; Belgium, \$30 million; Germany, \$275 million; Italy, \$200 million; and Switzerland, \$175 million. But France with total reserves of \$4.7 billion and liquid dollar holdings of \$1.4 billion at the end of June 1963, had bought none, nor had the Netherlands, holding in gold nearly \$1.6 billion of its \$2 billion international reserves.

(b) *Monetary and fiscal policies*

Adjustment to international imbalance implies responsibilities for surplus as well as for deficit countries. The latter must restrain inflationary forces, reduce costs, and endeavor in other ways to become more competitive in international markets. Surplus countries, on the other hand, should permit their increased reserves to exert some upward pressures on wages and incomes, thereby increasing imports, and downward pressure on interest rates, thus promoting capital exports. The United States itself experienced international pressures in the early postwar years, in part resulting from its financing of a large volume of exports under the Marshall plan and other aid programs.

The European countries have attempted, in recent years, to moderate inflationary pressures originating in part from their favorable international accounts. The character of their policies has had important balance-of-payments implications for the United States.

To avoid drawing capital from the United States, the surplus countries might reasonably be expected to attack their problem of inflation with a restrictive fiscal policy, without placing upward pressures on

their interest rates. This would be consistent with the policies urged upon the United States by these countries. They have advocated that the United States pursue domestic growth with an expansionary fiscal policy moderated somewhat by a restrictive monetary policy. And the United States has already moved to tighten short-term credit conditions, even though no tax cut has yet been enacted.

Instead of applying the logic of their arguments to their own circumstances, a number of surplus countries have tightened credit. France, in particular, has adopted an active policy of credit restriction. Its open market rates increased from 3.51 percent at the end of December 1962 to 5.26 percent at the end of July 1963. Belgium has twice raised its discount rate since the Federal Reserve increased its own rate in July 1963. Swiss money markets have been under strain, and interest rates have risen in all sectors. German long-term rates continue under pressure. These conditions intensify the difficulties confronting the United States in its efforts to move toward international equilibrium.

(c) Commercial policies

Commercial policy offers another opportunity for the surplus countries to fight inflation while at the same time promoting international equilibrium. Countries enjoying a favorable balance of payments and anxious to moderate price increases could unilaterally reduce trade barriers, thereby increasing competition within their home markets and permitting the deficit countries to improve their export earnings. In effect, the United States followed this policy in the early postwar years. In the important tariff negotiations at Geneva in 1947, Annecy in 1949, and Torquay in 1950-51, tariff reductions granted by the United States were put into effect, while those of the countries which are now in surplus were largely or wholly made ineffective by quantitative restrictions and exchange controls imposed to protect their balance-of-payments positions.

Other countries have made only limited use of commercial policy as a counterinflationary tool. Germany did so, before its commercial policy became integrated with that of the Common Market. And France and Austria have also reduced tariffs to combat inflation. Unfortunately, it now appears that protectionism rather than liberalism in commercial matters is gaining headway in Europe.

(d) Conversions of dollars into gold

Certain countries continue to convert dollars into gold, even though they are aware that this weakens the stability of the entire international monetary system.

Table 20 shows the international reserves and gold ratios of various regions and countries. It is evident that countries have very different interpretations of what constitutes an appropriate gold ratio. The United Kingdom, which also manages a reserve currency, takes the position that it must maintain a high reserve ratio. On the other hand, the Netherlands, with no reserve currency, has the highest ratio in Continental Europe—around 90 percent. Perhaps the Netherlands authorities have not forgotten that, as a result of the depreciation of the pound in 1931, they suffered losses exceeding the entire capital of their central bank.

TABLE 20.—Total international reserves and gold ratios by country and region

[Millions of dollars, year end]

	1948		1953		1958		1962	
	Total reserves	Gold ratio	Total reserves	Gold ratio	Total reserves	Gold ratio	Total reserves	Gold ratio
		<i>Percent</i>		<i>Percent</i>		<i>Percent</i>		<i>Percent</i>
Austria.....	(1)	(1)	320	16.2	665	29.2	1,055	43.0
Belgium.....	938	66.5	1,088	71.3	1,497	84.8	1,622	84.2
France.....	(1)	(1)	829	74.4	1,050	71.4	3,610	71.7
Germany.....	295	(1)	1,737	18.7	5,732	46.0	6,447	57.1
Italy.....	539	17.8	768	45.1	2,082	52.2	3,441	65.2
Netherlands.....	357	46.8	1,163	63.4	1,470	71.4	1,743	90.7
Portugal.....	(1)	(1)	665	54.3	776	63.5	792	59.5
Spain.....	118	94.1	149	87.2	66	86.4	1,029	43.3
Sweden.....	233	34.8	533	41.1	491	41.5	753	24.0
Switzerland.....	1,660	83.6	1,768	82.5	2,063	93.3	2,872	92.9
All Continental								
Europe.....	5,992	61.2	9,990	54.4	17,240	58.3	24,945	64.8
United Kingdom.....	2,009	79.9	2,546	84.8	3,105	90.4	2,809	91.9
Canada.....	1,011	39.7	1,827	54.0	1,948	55.3	2,547	27.8
Japan.....	()	()	823	2.2	861	6.3	1,842	15.7
Latin America.....	2,975	50.4	3,300	58.2	3,110	55.8	2,265	52.3
United States.....	24,399	100.0	22,091	100.0	20,582	100.0	16,156	99.4
Rest of world.....	10,064	11.7	10,958	35.7	10,224	16.9	10,801	20.7
World total.....	46,450	70.5	51,535	66.7	57,070	66.6	61,365	63.9

¹ Not available.

Source: Prepared from IMF, International Financial Statistics, various issues.

It may be relevant to note Ragnar Nurkse's observations, in his classic study of the interwar currency experience, concerning the forces bringing about the collapse of the gold exchange standard in the 1930's.

One serious weakness of the gold exchange system was the great variability in the degree to which central banks relied on exchange reserves as against gold. To understand the causes of this variability it is necessary to consider the motives that led individual countries to adopt the gold exchange standard and to adhere to it. The principal motive should have been a realization of the common interest or, in negative terms, the fear of a worldwide deflation. But individual countries were inclined to neglect the external repercussions of their actions; and the threat of a world deflation was, to each of them, a remote and ineffective sanction.

* * * The holding of foreign balances instead of gold in the central monetary reserve came to be regarded as damaging to the prestige of a great or even a moderately great nation. It is largely for this reason that the countries whose balances were in absolute amount the most important—including, for instance, France, Germany, Italy, Poland—did not regard their own use of the gold exchange standard as anything but a transitory expedient.¹²

X. INTERNATIONAL LIQUIDITY AND PROPOSALS FOR REFORM

It is difficult both to measure international liquidity, and to assess its adequacy. The adequacy depends on more than gold and foreign exchange; it encompasses also the capacity of countries to borrow from each other and from international organizations. And there is no exact relationship between the volume of international transactions

¹² Ragnar Nurkse, "International Currency Experience," (League of Nations, 1944), p. 42.

and the level of needed reserves; reserves are necessary to finance imbalances between international payments and receipts, not international transactions as such.

Despite the difficulty of measuring the adequacy of liquidity, it appears that the growth of gold reserves is too small in relation to the increase in international transactions to permit gold, at present prices, to provide the answer to the world's future needs. In 1962, free world exports were nearly 70 percent higher than in 1952, but gold reserves at the end of 1962 were only 16 percent above the 1952 yearend level. Particularly disturbing is the diminishing proportion of the free world's gold production which, over the years, has found its way into official reserves. In the 5 years following 1952, 63 percent of gold production went into official reserves. In the next 5 years the proportion fell to 45 percent. And in 1962, less than 25 percent of gold production became available for international reserve purposes.¹³ But even if all of the free world's gold production had gone into official reserves after 1952, gold reserves would have increased only 29 percent.

It has long been recognized that the expansion of the world's gold reserves might be inadequate to cope with the world's growing liquidity needs. A Genoa Conference in 1922 recommended the widespread adoption of the gold exchange standard as a solution to the problem. And a specially designated gold delegation of the League of Nations recommended in 1930 and again in 1932 that countries act in concert to change their legal gold reserve requirements against domestic money so as to regulate the volume of gold freely available for international purposes. But the abnormal circumstances of the late 1920's and 1930's eliminated, for the time being, the threat of a worldwide gold shortage.

There has been considerable discussion in recent years of the question whether or not there is currently an international liquidity shortage. The consensus of expert opinion is that there is no such shortage today, although many believe that such a shortage is likely to occur in the future. The United States had, in mid-1963, gold reserves of \$15.8 billion, 40.2 percent of the gold reserves of all free world countries. And its total reserves, including the IMF gold tranche position, were \$17.1 billion at that time. Yet, however large these reserves in absolute amount, they are by no means excessive in relation to U.S. liquid liabilities. On the other hand, the other industrial countries generally have large or at least adequate reserves. The less developed countries have a shortage of international liquidity, but this is only a symptom of a more basic and serious capital shortage. Increases in world liquidity would not, in present circumstances, be of lasting benefit to the reserves of these countries; they tend to spend incremental foreign exchange receipts rather than add to their reserves. The problems of the less developed countries must be, and are being, approached through grants, long-term loans, technical assistance, selective commodity stabilization programs, and efforts to broaden markets for their products, and, in the case of financial emergencies, through balance-of-payments assistance.

The immediate problem is the achievement of a better balance in American international payments, not an inadequacy of international liquidity in the monetary system as a whole. But the outlines of the future liquidity problem are already clear. In essence, the problem

¹³ International Monetary Fund, International Financial Statistics.

is that, with increases in the monetary gold stock lagging behind liquidity needs, national currency holdings must form an ever-increasing part of total international reserves. This implies an increase in relation to their gold stocks of the liquid liabilities of the countries whose currencies are held as reserves by other countries. But when these liquid liabilities grow substantially beyond the reserve-currency countries' own gold reserves, confidence may be diminished in their continuing ability to maintain the par values of their currencies, and the stability of the entire monetary system may be undermined. To be sure, this way of putting the problem is an oversimplification. The need for additional international liquidity does not grow in direct proportion to the volume of international transactions, and there is no precise relationship between the magnitude of liquid claims against a country's gold reserves and the degree of confidence in its currency. But increases in international transactions tend to raise the need for international reserves, and there may be limits to the volume of international liquid liabilities which a given volume of gold reserves can support without an undermining of confidence in the currency concerned.

To remedy the defects and dangers of the present system, a number of proposals have been made. Not all can be examined or even mentioned here, but a few of the leading proposals are touched upon.

(1) *Devaluation of the dollar relative to other currencies, or in concert with other countries*

While the United States would benefit if it could reduce its price levels in foreign markets, it seems unlikely that devaluation by the United States could lead to this result. Other countries would probably devalue along with the dollar to maintain existing exchange relationships and to prevent the United States from gaining a competitive advantage at their expense. A leading argument against devaluation by the United States is that any such attempt would result in an international monetary crisis. Other countries, acting in reliance on U.S. promises that the dollar would not be devalued, have acquired over \$23 billion of liquid dollar assets, of which more than \$12 billion are held as official monetary reserves. If the dollar were devalued, other countries might be reluctant again to trust it as a store of international value, and international liquidity could be correspondingly reduced.

It is sometimes suggested that this difficulty could be overcome if the United States, acting in concert with other countries, were to devalue to such a degree that the increase in the value of gold stocks would more than offset the decline in international liquidity resulting from the conversion of all foreign-held dollar balances into gold. Such devaluation could result in increased international liquidity by increasing the value of existing gold stocks and by encouraging an expansion of gold mining. But there remain substantial, if not insuperable, difficulties with such a plan. Changes in the par value of the dollar would require legislative action by Congress and consultation with the IMF. The publicity attendant upon congressional proceedings would probably result in massive speculation which could exceed the resources available to defend the system. Moreover, devaluation would reward and provide new incentives for gold speculators and hoarders, and would thus tend to diminish the proportion

of newly produced gold going into official reserves. The way would thus be paved for another liquidity crisis in the future.

Finally, the benefits of devaluation would accrue to countries in proportion to their existing gold holdings. Countries with low reserves, in need of greater liquidity, would receive little benefit. Countries which had cooperated with the U.S. and held a large proportion of their reserves in dollars would be penalized in relation to less cooperative countries with higher gold ratios. And devaluation would give a continuing reward to the major gold producers, South Africa and the U.S.S.R. Finally, the profits resulting from devaluation might generate inflationary pressures which would raise the value of international transactions and increase the need for international reserves, thereby absorbing all or a part of the increased reserves resulting from the devaluation.

(2) *Flexible exchange rates*

Flexible exchange rates equilibrate the demand for and supply of foreign exchange by moving with the pressures of imbalance, and in this way they dispense with or greatly reduce the need for international reserves. Determination of the prices of foreign currencies through the forces of supply and demand has not found favor with central bankers and monetary authorities who might, in other matters, advocate establishment of prices by free market forces. Many academic economists, on the other hand, endorse flexible exchange rates. The present system, itself, is a compromise between fixed and flexible rates, in that the IMF articles of agreement provide for changes in exchange rates in cases of "fundamental disequilibrium." Rates which move from one fixed level to another under this system are, in reality, not fixed, but sporadically adjustable. In descriptions of the present system, it is the fixity rather than adjustability of rates which is most often emphasized, for experience has shown that doubts concerning the stability of existing rates frequently lead to disturbing currency speculation which can tax all of the resources of the international monetary system, even if rates are not in fundamental disequilibrium.

It is argued on behalf of fixed exchange rates that, by eliminating uncertainty, they increase international flows of goods, services, and capital. On the other hand, it may be said that the optimizing, rather than maximizing of international transactions should be the goal, and optimizing implies that the international sector as well as the domestic should bear the burden of adjustment to international imbalance. Under fixed exchange rates the burden falls disproportionately on the domestic sector.

The world's practical experience with flexible exchange rates has not been reassuring. In the period between the two world wars, a number of countries had flexible rates for various periods of time. The French experience from 1919 to 1926 is perhaps most striking. The French franc suffered large fluctuations as a result of speculation concerning its future value. Psychological factors often resulted in large cumulative and self-aggravating movements of the exchange rate, with destabilizing rather than equilibrating effects. Canada's postwar experience with its "floating" dollar has often been cited as a successful example of a flexible exchange rate system. However, Canada was forced to abandon this system and to adopt a fixed value.

for its currency in 1962. After several years of reduced capital imports, substantial doubt arose concerning the future value of the Canadian dollar, and heavy speculation against that currency severely depleted Canada's reserves.

It would be difficult to forecast how flexible exchange rates might operate in present-day circumstances. Perhaps actual experience has been too limited and confined to periods of disturbed conditions to provide an adequate basis for judgment. Advocates of flexible rates may have underestimated the disruptive potential of speculative capital movements. Yet the present system is not speculation proof. Indeed, it is sometimes accused of encouraging speculation by limiting the possibility of loss through the small margin of rate fluctuations around par while providing the possibility of substantial gain in case of devaluation.

(3) *The establishment of a credit-creating international central bank.*

In establishing international credit facilities, two questions are paramount:

1. How much lending should be compulsory for surplus countries?
2. To how much credit should deficit countries be entitled?

The importance of these questions may perhaps be best understood by considering the International Monetary Fund, as it functions today. Under the present arrangements, the commitments of countries to lend are defined by the sizes of their respective quotas. These quotas also are relevant, but not decisive, in determining the borrowing limits of deficit countries. A deficit country, normally entitled to draw up to 125 percent of its quota, would not be able to do so if the Fund had an inadequate supply of the surplus countries' currencies.

* * * prospective surplus members of the Fund did not promise to extend credit to the amount of the aggregate of quotas of the deficit countries, but only to the extent of their own contributions to the Fund. Since the sum of quotas of the potential deficit countries was at the time [of the Fund's inception] larger than the sum of the quotas of the potential surplus countries, the Fund agreement was marred from the beginning by an insufficiency of the Fund's resources and by the necessity of bolstering the Fund's asymmetrical structure through repurchase and scarce currency provisions (the latter even implying exchange control measures).¹⁴

The supplementary borrowing arrangement of the IMF, recently negotiated with 10 leading convertible currency countries, redresses this asymmetry to some extent. But under the Fund's Articles of Agreement, the surplus countries' contractual responsibilities to provide credit are rigidly defined, while the rights of debtor countries are indeterminate within the outside limits set in relation to their quotas.

Contrast this situation with the one that would result if the IMF could create international legal tender. Suppose that the Fund were determined to increase international liquidity 3 percent a year—a seemingly modest amount—by engaging in open market purchases of the domestic financial assets of deficit countries. If the surpluses corresponding to the deficits mainly accrued to one or a small number of countries, what might appear as a modest increase in total international liquidity could entail heavy responsibilities for a few countries to provide credit by accepting the IMF's currency in exchange for goods and services. Under this system, where, in the limiting case,

¹⁴ George N. Halm, "Special Problems of a Key Currency in Balance-of-Payments Deficit," in Joint Economic Committee, "Factors Affecting the U.S. Balance of Payments," 1962, p. 548.

the entire increase in the world's liquidity could find its way into the reserves of one creditor country, the balance of advantage is clearly shifted from surplus to deficit nations. Surplus countries would be unable to determine how much of the credit resulting from the IMF's international money creation would ultimately have to be provided by them. Of course, their responsibility could be controlled by limiting the rate at which the IMF could create international currency, but a low rate of growth would limit the usefulness of the plan to deficit countries.

We cannot here explore in depth the questions raised by the concept of an international credit-creating bank. The important thing to bear in mind is that, beneath the veil of institutional procedures and practices, credit would ultimately be provided by the surplus countries or by countries with large reserves to the deficit countries. Any international monetary arrangement must provide for some balance between the rights of those with deficits and the responsibilities of those with surpluses. The mechanics of various plans, which often are bewildering in their complexity, must not be allowed to obscure the underlying debtor-creditor relationships which are involved.

It has often been pointed out that the establishment of a money-creating international bank would imply some potential conflict between the measures adopted by the bank and the national policies of member countries. The open-market operations of such an institution might be inconsistent with the monetary policies being pursued by the countries in which such operations take place. And the ultimate result of credit creation might be large demands for the goods and services of countries which are endeavoring to restrain inflationary pressures.

The problem of possibly conflicting policies is often raised in terms of the loss of monetary sovereignty on the part of countries affected by the credit-creating bank. But this is somewhat misleading, for international considerations must play a role in national policies under any system. For example, even under the present system, the balance-of-payments difficulties of the United States have placed limitations on its freedom of action. The United States has been obliged to adopt a host of measures, such as tying aid, procuring military supplies at home despite greater budget costs, and raising interest rates at a time of substantial unemployment, all of which are undesirable in themselves and justifiable only in terms of the exigencies of the balance of payments.

(4) Multiple key currency system

The possibility that this system might evolve from the present order was first raised at the official level by the Under Secretary of the Treasury Robert V. Roosa in his article "Assuring the Free World's Liquidity" published by the Federal Reserve Bank of Philadelphia in September 1962. Mr. Roosa suggested that a return to surpluses in the U.S. balance of payments need not result in a depletion of the international reserves of other countries, as the United States could acquire foreign currencies in its reserves, thus extending credit to other countries in the same way that credit has been provided to the United States by countries holding dollars. Indeed, the United

States has already found it useful to hold foreign currencies in its reserves for the purpose of operating in foreign exchange markets.

To the extent that surplus countries generally accepted a deficit country's currency instead of requiring it to pay in gold or in the currency of another country, deficits would lead to an increase in international liquidity. Of course, the world's net reserves would remain unchanged.

The increase in the world's effective liquidity would probably be somewhat less than the increase in foreign exchange held as reserves. To an important degree, liquidity is psychological. Its limits are defined by how far countries are willing to go in pursuing policies that could require them to use their reserve assets and seek credit. To the extent that countries tend to focus on their net reserve positions the acquisition of their currencies in times of deficit by surplus countries would be experienced as a loss of liquidity. On the other hand, an unlimited willingness of surplus countries to accumulate the currencies of deficit countries would eliminate the possibility of an international liquidity shortage and the necessity for a deficit country to bring its balance of payments into equilibrium.

Proponents of the multiple key currency system see as one of its principal advantages the absence of any compulsion to lend. A surplus country would be free to decide for itself what amounts, if any, it wished to acquire of a deficit country's currency. If surplus countries were no longer willing to add to their holdings of a deficit country's currency, that currency's exchange rate would fall until the deficit country had to support it by selling its gold or holdings of the currencies of other countries. The absence of a commitment to acquire the foreign exchange of other countries is, of course, an advantage to the surplus countries, who retain complete freedom of action, but a disadvantage to the deficit countries who cannot be assured of credit. Another advantage of the multiple reserve currency system is that it could tend over time to equalize the ratios between gold and liquid liabilities of the participating countries.

However, a number of important problems are raised by the concept of a multiple key currency system. What currencies would be held and in what amounts? The French franc is now strong, but it was devalued three times in the postwar period. Would such a currency be a suitable reserve asset for other countries? Inasmuch as the plan provides for the accumulation of other countries' currencies precisely during periods when they are in deficit, i.e., when their currencies are weak, is it likely that these currencies would be regarded as attractive stores of international value? How could creditor countries be protected against losses resulting from the devaluation of currencies they hold? What would be the role, if any, of exchange guarantees?

If participation in the plan were entirely optional, wouldn't the entire system be vulnerable to crises of confidence, made more dangerous and potentially disruptive by the pyramiding of credit on a slowly growing gold base? Wouldn't the system require certain commitments as a minimum—perhaps concerning the percentages of gold in the reserves of participating countries, and the composition of foreign currency holdings other than dollars?

The evolution of a multiple reserve currency standard could provide for the growth of international liquidity, but, because participation is optional, it is not clear that such growth would actually come about.

But whatever its difficulties, the international monetary system appears to be evolving toward a multiple key currency system. The plan merits further study and public discussions so that its implications may be better understood.

In reviewing these plans and proposals, it is clear that ideas for basic reforms of the international monetary system have so far outstripped actual accomplishments, considerable as these have been. The major accomplishments of the past few years include the negotiation by the United States and nine other countries of an agreement to lend the IMF up to \$6 billion subject to certain conditions; the creation of a network of currency swaps which may be activated in the event of international monetary disturbances; the formation of a gold pool to prevent destabilizing price movements in the London gold market; and, in general, the development of an unprecedented degree of cooperation among the central bankers and monetary authorities of the free world.

At the 1963 annual meeting of the Board of Governors of the IMF, the group of 10 nations participating in the Fund supplementary borrowing arrangement announced that they would begin a thorough examination of the prospective functioning of the international monetary system and improvements that might be necessary to ensure adequate liquidity. It is understood that this examination will not cover devaluation and flexible exchange rates. During the same meetings, the IMF announced that it, too, would undertake a far-ranging study of international liquidity and the functioning of the international monetary system. Both studies are expected to be completed sometime in 1964, and both will play an important role in shaping the further evolution of the international monetary system.

PART II
FOREIGN ASSISTANCE CRITERIA AND
BALANCE-OF-PAYMENTS PROBLEMS

By the
Program Coordination Staff, Agency for
International Development

FOREIGN ASSISTANCE CRITERIA AND BALANCE-OF-PAYMENTS PROBLEMS

PROGRAM COORDINATION STAFF, AGENCY FOR INTERNATIONAL DEVELOPMENT

Current concern about the U.S. balance-of-payments position has focused attention on the following basic question: What balance should be sought among the several objectives of maintaining an adequate foreign assistance program, providing that assistance in the most efficient form and at the same time minimizing adverse balance-of-payments effects?

The balance-of-payments impact of foreign assistance can be reduced either by reducing the amount of assistance, or by altering the composition and techniques of administering the assistance programs, or by a combination of these approaches. Adjustments in the level of economic assistance on balance-of-payments grounds must be considered in the broader context of the total costs of and benefits derived from that assistance. Changing the composition of assistance in order to reduce adverse payments effects may reduce its effectiveness.

This paper describes the criteria which are currently applied by the U.S. Government in allocating foreign economic assistance as well as the relationships between assistance and the balance of payments. The purpose is to provide more adequate background on the issues which are involved.

1. THE PURPOSE OF FOREIGN ASSISTANCE

The major objective of the U.S. foreign assistance program is to assist other countries that seek to maintain their independence and develop into self-supporting nations. This objective is predicated on the belief that the resulting community of free nations, cooperating on matters of mutual concern, offers the best long-run prospect of security and peace for the United States.

This community will grow in strength as the less-developed countries attain social justice and rising standards of living. At present, their human skills, institutional framework, and capital resources are inadequate to meet rising internal demands for such progress. We seek to help the less-developed countries realize their hopes by a process of economic and social development compatible with our basic objectives.

In countries facing immediate internal or external threats to their security and independence, military assistance and supporting economic aid are used to help avert or defeat the threat. In countries lacking basic law and order, administrative services, and political continuity to launch a serious development effort, U.S. assistance may help to establish these preconditions for growth. In many more countries, U.S. capital and technical assistance are used to speed development efforts already underway. In some of these countries,

the United States carries the major burden of external aid; in others, our aid is small and supplements that of other donors who bear primary responsibility for extending assistance.

Clearly, a central objective of extending aid is to help each country reach the point at which its own resources and its ability to attract investment and credit on commercial terms are adequate to sustain satisfactory growth.

In each country to which the United States extends aid, the assistance program usually serves several foreign policy objectives. However, in most programs one major objective is dominant. Country programs, therefore, may be grouped into three general categories according to the nature of our objectives and the extent of our participation: (1) substantial programs directed to long-term economic and social development; (2) substantial programs dominated for the immediate present by the need to maintain external and internal security, but aiming at economic development in the long-run; and (3) limited programs with more restricted objectives.

(a) Substantial programs for long-term development

About 30 countries receive substantial assistance for long-term development and are judged to have good prospects of attaining self-sustaining growth within a reasonable period of time if they make effective use of the internal and external resources available to them. These countries receive almost 90 percent of all U.S. development lending. They fall into three groups:

Countries which are approaching self-sustaining growth and in which needs for further assistance on favorable terms are relatively limited. This group includes Venezuela, Mexico, Jamaica, Israel, Greece, and Taiwan.

Countries following relatively effective development policies and making reasonable progress toward self-sustaining growth. This group includes India, Pakistan, Turkey, and Nigeria.

Countries with potential for development but in which adequate self-help measures are not now being demonstrated.

In the first two groups the United States is in substantial agreement with the country's internal development objectives and with the manner in which they are being pursued. In most of these countries, there have also been substantial increases in investment and in private and public saving; dependence on external assistance is not excessive given their present stage of development.

In the third group of countries, where the adequacy of development policies has yet to be demonstrated, U.S. aid is related to the adoption of self-help measures. The U.S. approach may take a variety of forms. The general procedure is to agree with a government on a set of key policies and to condition the amount of aid upon the country's performance. In these countries, the United States is interested in increasing the domestic financing of development and in encouraging policies which alleviate balance-of-payments deficits and utilize total resources more effectively.

U.S. assistance to these 30 countries, combined with other external sources, can make the difference between sustained increases in per capita income and economic stagnation. It is reasonable to hope that, over the next decade, as many as half of these countries will have reached a stage of self-sustaining growth in which they can meet

their needs for foreign capital through private foreign investment, loans from international institutions, and other similar sources.

(b) Substantial programs to promote security and development

In a small number of critical countries, it is necessary for the United States to help establish external and internal security before turning to long-term economic and social development. Some of these countries border on the Communist world and, in these, economic aid may be limited in comparison to the military assistance being given. Such military aid provides support to friendly countries for the maintenance or restoration of their internal security and self-defense.

The general objectives of aid in these circumstances are to move from stabilization programs to setting the stage for economic and social progress. A mixture of military aid and supporting assistance is usually provided in the early stages of this sequence, with a gradual shift to development assistance and an increasing proportion of loans as economic conditions improve.

Looking over the past decade, one can observe three phases through which a number of countries have moved in recovering from political or military upheavals with external help. In the first phase, external security and a minimum of internal law and order are established. In the second, political and economic institutions are strengthened and the economy is stabilized. In the third, economic growth is resumed and dependence on extraordinary grant assistance is steadily reduced and then eliminated.

Some countries, such as Greece and Taiwan, have moved to the last of these phases in a period of 8 to 10 years. Others seem likely to complete the cycle in even less time; but some may take longer. U.S. aid strategy in all these countries is to help them to mobilize their domestic resources and to steadily reduce their reliance upon any form of external support through development of their economic strength.

(c) Limited aid programs

In more than half of the countries receiving economic aid, U.S. objectives are considerably more limited in nature, and involve correspondingly limited commitments and expenditures. Planned U.S. aid to these countries in fiscal year 1964 amounts to less than 12 percent of total economic aid funds.

Many of these programs are in African countries which rely primarily on Western European assistance to speed their development. In these countries modest U.S. assistance is designed to demonstrate interest in and support for the country's efforts without assuming substantial commitments. In some cases this marginal assistance may make it politically possible for recipient governments to continue to rely primarily on Western European assistance, by heading off the charge of total dependence on the former metropole. U.S. assistance in these countries is almost entirely technical assistance, but occasional development loans may be made for selected projects which are economically sound and will contribute substantially to growth.

Some countries receiving limited aid from the United States are dependent on the Communist bloc for substantial amounts of assistance. If alternative sources of aid are lacking, the long-term Com-

minist objective of achieving increased influence in key economic and political sectors in these countries may be furthered. Although the United States does not seek to outbid Communist offers, it is in our interest to prevent excessive dependence on bloc assistance in strategic countries.

In these and other limited assistance efforts, the choice of aid activities represents a compromise between the requirements of the specific objective and the general aim of providing aid in as useful and efficient a way as possible.

2. THE AMOUNT OF U.S. ECONOMIC ASSISTANCE TO DEVELOPING COUNTRIES

The appropriate level of U.S. foreign economic assistance may be approached in three ways:

(a) In the international context, as a fair share of the total amount of assistance provided from all sources to all developing countries;

(b) In the domestic budgeting context, balancing the benefits of the program for the United States against its costs and the alternative uses to which aid funds might be put; and

(c) In terms of the appropriate level of U.S. aid programs in particular countries which taken together comprise the total U.S. program.

(a) *The U.S. share of worldwide economic assistance*

In the international context, the United States has a major interest in assuring a flow of resources from all donors to the developing countries adequate to meet their requirements. We are willing to carry a fair share of the total burden, but are concerned to avoid an undue share.

Total capital receipts by developing countries from all sources in 1960 were approximately \$7.6 billion, and in 1961 reached roughly \$8.8 billion.¹ Fully comparable figures for 1962 are not available, but disbursements by DAC members remained at about the same level as in 1961.

By what standards can we judge whether this flow is adequate to meet the requirements of the developing countries? Several standards have been proposed, but none is very satisfactory. One approach is to estimate the total external assistance required by all less developed countries in order to raise their rates of growth of per capita income to some specified level. Having thus determined the "requirements" for external assistance, the burden of providing this assistance could be divided among the developed countries on the basis of their national income or some similar formula. This approach has several defects. It assumes that all developing countries are capable of achieving the same rate of growth. It ignores the differential abilities of the developing countries to utilize external assistance efficiently. Furthermore, it would require general acceptance by the developed countries to be effective. A modified version of this proposed standard would be based on an estimate of the total external assistance which could be effectively absorbed by all of the developing countries, given their

¹ Includes net bilateral disbursements, public and private, from the OECD countries, Japan, Australia, New Zealand, and the Sino-Soviet bloc and from multilateral agencies. Source: "The Flow of Financial Resources to Developing Countries in 1961," OECD.

present limits of administrative and technical personnel, institutional organization, and development policies. This criterion is in fact used by AID in determining the level of aid for countries where our aid is substantial relative to their resources. However, the criterion yields no automatic formula: there are both conceptual and technical problems in applying it. Even if there were some simple measure of the "efficiency" with which assistance is used, a judgment would still be needed as to what level of efficiency should be regarded as adequate. Moreover, the amount of aid which a country can utilize effectively is not fixed. One of the most important functions of external assistance is to increase the developing countries' ability to use their own and others' resources effectively by training administrative and technical personnel, helping to strengthen institutional organization, and inducing improved development policies.

As an alternative approach, it has been suggested that all developed countries should devote up to 1 percent of their gross national product to foreign assistance. This is obviously an arbitrary criterion bearing no direct relation to the needs of the developing countries, and is more relevant as a burden-sharing formula than as a standard for the total flow of aid.

In both 1960 and 1961, U.S. disbursements of public and private grants and loans were roughly half of the total resources made available to developing countries. In terms of aid as a proportion of the donor's national income, however, the United States ranked behind France and Portugal in 1961. U.S. aid terms are more favorable than those offered by many donors, but even if all the various forms in which different donors make aid available are reduced to their grant equivalents,² France was still contributing a much higher proportion of GNP than was the United States. To the extent that the proportion of the donor's GNP taken by aid is a valid index of the aid burden, the United States carries a heavier-than-average share of the burden but is not dramatically "out of line."

(b) *The amount of U.S. economic assistance as a domestic budgeting problem*

Moving from the international burden sharing context to the domestic context of allocating U.S. resources among alternative uses, determining the appropriate level of U.S. foreign assistance becomes an aspect of the general governmental budget formulation process which is conducted jointly by the executive branch and the Congress. The benefits to be derived for the United States from spending one additional dollar on foreign assistance must be weighed against the other uses, public and private, to which that dollar might be put.

(i) *Benefits.*—It is impossible to measure with precision the benefits of U.S. development assistance, in terms of the goals stated earlier in this essay. However, it is possible to survey the records of the countries to which the United States has given substantial assistance over several years, and judge whether progress has been substantial, moderate, or absent.

² This can be done by subtracting the discounted present value of loans from their nominal total value. Different discount rates of course yield different grant equivalents. Statement in text based on a study by John Pincus, Rand Corp., using discount rates of 5.75 percent, the international lending rate, and 7 percent, the marginal DAC lending rate.

The 10 developing countries which have received the largest amounts of U.S. assistance since World War II are Korea, China, the Philippines, Vietnam, India, Pakistan, Israel, Turkey, Greece, and Brazil. On a per capita basis, American aid has been relatively small in India, Pakistan, and Brazil.

Together these 10 countries have accounted for about 60 percent of total economic and 70 percent of total military assistance to all countries outside Western Europe and Japan.

Three of these countries—Taiwan, Israel, and Greece—have achieved exceptionally high rates of economic growth over the past decade, despite serious international threats and the need to maintain large armed forces.

The average annual increase in real gross national product from 1950 through 1961 was 6 percent for Greece, 7.5 percent for Taiwan, and 10 percent for Israel. These countries are now on the road to continuing economic progress with a diminishing need for external economic aid. Assistance programs will be terminated in the next few years.

The Philippines and Brazil have had satisfactory growth rates—about 5 to 6 percent annually. Growth has been less satisfactory in Turkey, particularly in the latter part of the decade. None of these countries has yet approached the rate of progress their natural and human resources would seem to permit. Recent changes in governmental and economic policy in all three countries provide grounds for hope they will develop more effectively in the current decade and have less need for external assistance.

Considering the base from which they started 10 years ago, both India and Pakistan have made very substantial progress.

A larger supply of skilled and professional manpower and a more stable government made it possible for India to undertake serious development efforts at an earlier date than Pakistan, and India's annual rate of growth—4 percent—between 1950 and 1961 was appreciably higher than that of Pakistan. Since 1959, however, the rate of economic growth in Pakistan has apparently exceeded that in India.

Both countries have invested heavily in basic utilities—transportation, power, and irrigation—which should contribute to higher rates of growth in the coming decade.

The two remaining countries which have received large-scale assistance from the United States are Korea and Vietnam. The 3-year war in Korea and current fighting in Vietnam have required large-scale military aid and commodity shipments to prevent economic collapse.

Korea has largely recovered from the war and is laying foundations for future development, but the need to maintain large defense forces continues to drain its economy. In Vietnam, economic development was impressive during the peaceful 5 years between 1954 and 1959, but it is currently arrested and U.S. assistance is focused on restoring internal security.

Although U.S. aid was only one of the many factors affecting the outcome in these countries, it contributed a substantial part of the funds available for gross investment and, in most cases, a much larger share of foreign capital available for financing needed development imports. Sample figures are shown in the following table.

Economic growth and U.S. economic assistance

	Israel	Taiwan ¹	Greece	India
Average annual growth rates (1950-60, percentage increase).				
(a) Population.....	4.1	3.4	0.9	2.0
(b) Gross national product.....	10.0	7.5	6.0	4.1
(c) Per capita gross national product.....	6.5	4.3	5.2	2.1
Cumulative investment and external resources (1950-61, in billions of U.S. dollar equivalents).				
(a) Gross investment.....	3.5	2.4	5.6	44.4
(b) Net inflow of foreign capital and donations.....	3.8	1.2	2.7	5.1
(c) U.S. economic aid ².....	.7	1.0	1.0	2.7
U.S. economic aid ² as a percent of—				
(a) Gross investment.....	20	43	18	6
(b) Foreign capital and donations.....	18	89	37	53

¹ Figures for Taiwan cover the period 1951-61.

² Aid figures are on an expenditure basis for the mutual security program, and an obligation or loan authorization basis for Public Law 480, Export-Import Bank and other U.S. economic programs.

It can safely be stated that U.S. assistance played a major role in establishing security and promoting development in many of the countries given substantial aid since World War II. In a few countries progress has been painfully slow. The importance to the United States of these achievements remains an independent question which must be judged in the context of our total foreign policy. This judgment would have to take into account the continuing pressure of Communist subversion, especially in Asia and Latin America, as well as increasing demands for social reform and economic growth throughout the underdeveloped world.

(ii) *Costs.*—The costs of the development assistance program include both the alternative uses, public and private, to which assistance funds could be put, and any adverse impact the program may have on fiscal, balance of payments, or other national objectives. The balance-of-payments “costs” of the program are discussed later in this essay.

In 1962, total U.S. economic aid commitments represented 0.34 percent of GNP, and economic aid expenditures were 2.1 percent of the Federal budget. Economic aid as a proportion of GNP has not risen above one-half of 1 percent since 1955, nor taken more than 3 percent of the Federal budget since 1952. In addition to AID funds, the flow of U.S. economic resources to underdeveloped countries includes contributions to international financial institutions such as the International Monetary Fund, net loans by the Export-Import Bank and deliveries of surplus agricultural products under the food-for-peace program. However, these programs place little additional burden on the U.S. taxpayer. Export-Import Bank loans are made on commercial terms (and are repaid in full with interest), and surplus agricultural products would be produced (and would have to be stored) whether or not there were a food-for-peace program.

Whether the benefits derived from the aid program are worth these costs is a subjective judgment which rests on two assessments: the value to the United States of the program's results, and the value to the United States of the most important alternative use for which the funds now going to aid, or some part of these funds, might be spent.

(c) *The level of economic assistance to particular countries*

The total amount of U.S. foreign assistance is a composite of the assistance to individual countries and, therefore, is based on judgments about the appropriate amount of aid for these countries.

Three basic principles determine the countries to which the United States offers development aid and the amounts and kinds of aid which they receive:

(i) The effectiveness with which the country can use available resources—both internal and external—to promote economic and social development;

(ii) The importance to the United States of sustaining or accelerating the economic growth of the country;

(iii) The availability to the country of other external resources in a suitable form.

(i) *Ability to utilize assistance.*—A country's ability to utilize external assistance not only reflects the determination with which its government and people seek to progress, but also the current stage of development of its human and institutional resources. Aid to countries in early stages of development normally must concentrate on technical assistance to train personnel and develop administrative services, educational institutions, savings, credit and trade associations, and other institutions needed to support growth. Assistance of this kind is complex and difficult, but it does not require heavy expenditures. Such aid is often accompanied by some capital assistance projects, directed to building roads, ports, power, and other infrastructure. Greater capital assistance will be required as the country's ability to undertake more varied productive capital projects grows. Meanwhile, the need for technical assistance is likely to continue, but its emphasis will probably shift from more general training and institution building activities to more specific bottleneck-breaking efforts. Later, the expanding economy should gradually generate greater domestic savings and investment and attract growing private foreign investment and increased support from sources such as the World Bank. In this way the need for foreign grants or loans on concessional terms will be progressively reduced.

The normal pattern of aid to a developing country—whether supplied primarily by the United States or by another donor or donors—therefore may require that the volume of aid increase before it is gradually phased out. The length of time required to complete the pattern will depend on the country's initial stage of development and on the vigor of its own efforts. Some countries may also be relatively advanced when aid is started and may not need the first stages of the sequence. Under the Marshall plan in Europe, the Europeans organized their own skills and energies to the task of rebuilding their war-devastated economies. The United States provided the crucial margin of resources which enabled the countries of Europe to overcome the need for outside economic aid within 5 years—from 1948 to 1953. In the less developed economies, the capacity to utilize outside help effectively is understandably much less than it was in Europe, and the period required to achieve self-supporting growth is likely to be substantially longer. Countries such as Israel, Greece, and Taiwan have achieved rapid development and increasing self-reliance over a period of 10 to 15 years. A similar period should be sufficient in many Latin American countries, but in many of the poorer countries of Asia and Africa the timetable will be considerably longer.

(ii) *Importance to the United States.*—In allocating development assistance, the importance to the United States of sustaining or

accelerating economic growth in particular countries is also considered. Historic links with a region or country are one major factor entering into this judgment. For example, the United States feels particularly close ties with Latin America as a whole, and with the Philippines and Liberia for historical reasons. Security considerations, including geographic location and alliance commitments, are a second major element determining the importance to the United States of supporting a country's growth. A country's influence in the international or regional community and its democratic record or current efforts to establish democratic government also enter into this judgment.

(iii) *Availability of other external resources.*—Where other donors are carrying the major burden of assistance, total U.S. aid is confined to levels which will demonstrate support for and interest in the country. In countries where no single donor bears primary responsibility, or where the United States is providing the bulk of assistance but other donors' contributions are substantial, the projected availability of others' aid enters into U.S. calculations of the country's foreign exchange requirements and supply. These projections are used in determining the level of assistance to the country. The level of U.S. assistance to countries for which consortia have been organized is worked out in the course of consortia negotiations.

3. FOREIGN ECONOMIC ASSISTANCE AND THE BALANCE OF PAYMENTS

In analyzing the relationship between foreign assistance and balance of payments, the following questions are most significant: How large is the impact of foreign assistance on the current balance-of-payments position? What have been the results of various policies which were instituted over the past few years in an effort to mitigate adverse balance-of-payments effects of the assistance programs? What are the longer run implications of foreign assistance programs for the balance of payments?

(a) *Current impact on the balance of payments*

The effects of foreign economic assistance on the balance of payments have been assessed in a study by the Brookings Institution³ and a statistical analysis undertaken by AID. The Brookings study estimates the effects on the "net basic balance" of all U.S. economic assistance in 1961 and projects the effects for 1968 allowing for changes in both the level and form of assistance. The AID study, based on actual changes in U.S. assistance and U.S. exports to 50 major aid-receiving countries between 1957-58 and 1961-62, derives a statistical estimate of the relation between changes in aid and changes in U.S. exports.

U.S. Government grants and capital outflow in 1961 are presented in the Brookings study as follows:

	<i>Millions of dollars</i>
AID and related programs.....	1, 794
Public Law 480.....	1, 350
Export-Import Bank.....	822
Investment in international institutions.....	172
Other and adjustment.....	- 82
Total.....	4, 056

³ Walter S. Salant et al., "The United States Balance of Payments in 1968" (Washington, the Brookings Institution, 1963), ch. VI.

This total is also shown in terms of its impact on the outflow of dollars:

Dollar payments to foreign countries and international institutions.....	1, 116
Transactions involving no immediate dollar outflow from the United States.....	2, 940
Total.....	4, 056

The Brookings report goes on to state:

Breaking down aid into the portion which gives rise to immediate dollar outflow, and the portion which does not, serves only one purpose: it reminds the user of balance-of-payments statistics that aid is not a total loss from the balance-of-payments point of view, even in the short run * * *. There is no reason to think, however, that the immediate dollar outflow represents the ultimate balance-of-payments cost of foreign aid or of any other debit item.

There may be balance-of-payments costs even when there is no dollar outflow. If countries receiving U.S. goods as aid reduce their normal imports of these goods from the United States and do not use the released funds in the United States, then there is a negative effect on the basic balance. Or if the aid causes them to reduce their imports from other nations (such as Canada) which would have used a large portion of the proceeds for purchases in the United States, it may cause some net increase in the basic U.S. deficit.

However, even when aid takes the form of untied cash transfers, the immediate dollar outflow is almost certain to overstate the balance-of-payments cost to the United States of the aid. In general, aid-receiving countries do not accumulate reserves for long periods. A cash grant adds to their spendable foreign exchange. Sooner or later, virtually all the original dollar outflow, except that which goes into Western European reserves, will be spent in the United States.

To correct for these deficiencies in the straight balance-of-payments data, the Brookings study estimates (a) the proportions of untied aid which would eventually return to the United States in the form of demand for exports, and (b) the extent to which aid-financed commodities and services are substitutes for exports which would have occurred in the absence of U.S. assistance. The first type of adjustment is not relevant for Public Law 480 and Eximbank assistance which are fully tied to U.S. exports.

The adjustments for AID-financed assistance are based upon the distribution of tied and untied assistance to various geographic regions in 1961 and the normal share of U.S. exports in the total imports of those regions.⁴ The Brookings conclusions arising from this analysis are shown below.

	Billions of dollars	Percent
Total AID expenditures in 1961.....	1. 92	100
Spent in the United States.....	. 75	41
Spent in the rest of the world.....	1. 07	59
AID expenditures:		
Financing a net increase in U.S. exports.....	. 97	53
Leaking into Western European reserves.....	. 85	47

Of total AID expenditures in 1961, 41 percent were spent in the United States in the first instance, but the Brookings study estimates that 53 percent resulted in a net increase in U.S. exports. On the other hand, although \$1.07 billion was spent in the rest of the world, \$850 million is estimated to have flowed into the reserves of Western

⁴ For a more detailed discussion, see pp. 170-174 of the Brookings study.

Europe, the difference of \$220 million having gone into additional U.S. exports.

The Brookings study indicates that the basis for estimating substitution under Public Law 480 and Eximbank loans is highly speculative, but suggests that perhaps 30 percent of these two types of assistance results in substitution for commercial exports.

On the basis of these estimates, the conclusion to be drawn from the Brookings study is that in 1961 total economic assistance of \$4.1 billion resulted in increased U.S. exports of about \$2.5 billion, or roughly 60 cents for each dollar of assistance.

The AID study of the relation between U.S. economic assistance and U.S. exports for the period 1957-58 to 1961-62 indicates that from 70 to 75 percent of total economic assistance resulted in additional U.S. exports of goods and services.⁵ The AID study further suggests that the favorable effect on U.S. exports from all types of foreign economic assistance was somewhat greater than the Brookings estimates. The results, however, are not conclusive in this regard and further analyses are currently underway.

The general findings of the two studies are that between 25 and 40 cents of each dollar of economic assistance failed to return to the United States during the periods studied. It should be noted that, during these periods, actual procurement under AID-predecessor programs was largely on a worldwide competitive basis.

(b) *Measures to limit the balance-of-payments impact*

Since 1959 a number of steps have been taken to assure that an increasing share of foreign economic assistance is spent in the United States. In 1959 financing under the Development Loan Fund was restricted primarily to U.S. sources. A second step was taken in 1960 when limitations were placed on procurement of commodities from 19 developed countries under U.S. grant aid programs. In 1962 AID introduced the use of irrevocable letters of credit in lieu of untied cash grants. The letters of credit can be used only to finance procurement from the United States. Also AID has recently adopted a policy to discontinue financing those commodities of which the United States is a net importer. Although these policies are subject to some exceptions, they now restrict procurement primarily to U.S. sources.

These various measures have resulted in a declining level of AID expenditures in the rest of the world since 1961 and further declines are projected as follows:

	Billions of dollars	Percent of total expenditures
Calendar year 1961.....	1.07	59
Fiscal year 1962.....	.88	54
Fiscal year 1963.....	.77	37
Fiscal year 1964 (estimated).....	.68	30
Fiscal year 1965 (estimated).....	.60	(1)

¹ Not available.

The share of AID obligations which is expected to result in expenditures outside the United States was less than 20 percent in fiscal year

⁵ Economic assistance covered by the AID study includes AID-type programs, Public Law 480, and Eximbank, and excludes repayments of interest and principal on loans. The 70-percent figure comprises both the direct exports from the United States to aid-receiving countries and the indirect effect on U.S. exports to third countries as a result of increased expenditures by the aid-receiving countries on exports from other countries. The AID study is based on a multiple regression cross-sectional analysis of the 50 principal aid-receiving countries.

1963 and is estimated at 17 percent in fiscal year 1964. As these obligations are expended in subsequent years, the result will be further reductions in the share of non-U.S. expenditures.

The Brookings study estimated that, given the procurement policies at the time of the study⁶ and the use of irrevocable letters of credit, the effect would be to raise the share of AID expenditure which would return directly or indirectly to the United States to 70 percent.

AID estimates are that by raising the share of its expenditures which result in direct U.S. procurement to 80 to 83 percent, the net effect on exports will be of about the same magnitude. Thus AID estimates of the program's adverse balance-of-payments effect are slightly more optimistic than those of the Brookings group. As pointed out in the Brookings study, "the higher the proportion of AID expenditures that are tied to U.S. procurement, the greater the recipient country's incentive to use AID funds to finance normal imports from the United States." It is largely a matter of judgment and speculation as to the point at which this substitution effect will offset the gains from increased tying of U.S. assistance.

(c) *Longrun effects on the balance of payments*

In addition to its shortrun costs, foreign economic assistance has longer run implications for the U.S. balance of payments. These longer run effects are both positive and negative and no reliable judgment can be reached as to what the net effect on the United States will be.

The positive longrun payments effects of economic assistance derive mainly from the contribution such assistance makes to the growth in income of the recipient countries. This income growth will result in increased demand for imports, part of which will come from the United States. Other positive effects should result from increased awareness of U.S. products as a consequence of having obtained such products through the economic assistance program. Also some aspects of the Public Law 480 programs are specifically intended to develop commercial markets for U.S. agricultural commodities.

The return flow of payments under foreign assistance loans will produce a direct benefit for the U.S. balance of payments. At the same time these payments will result in some offsetting loss in U.S. exports because of the reduced importing capacities of the countries making repayment.

Negative effects on the U.S. balance of payments in future years can be expected from the increased efficiency of production in the countries now receiving U.S. assistance. More efficient production of import substitutes and potential exports will result in increased competition for American producers both in world markets and within the United States.

It is important to remember, however, that the economic growth and the increase in efficiency of production which do occur in countries receiving assistance will depend on many factors other than the amount of assistance which the United States provides. The relative rates of growth of the United States vis-a-vis other countries, changes in technology and tastes in the United States and the rest of the world, internal monetary and fiscal policies—these are the critical elements which will dominate the evolution of the U.S. balance of payments over the coming years.

⁶ The policy of not financing those commodities of which the United States is a net importer had not yet gone into effect when the Brookings study was completed.

PART III
DEFENSE PROGRAMS AND THE BALANCE OF
PAYMENTS

—
By the
Department of Defense

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DEFENSE PROGRAMS AND THE BALANCE OF PAYMENTS

DEPARTMENT OF DEFENSE

PART I

INTRODUCTION

The relationship between our national defense and our national balance of payments can best be understood by looking first at the broad context in which today's military needs have arisen. It seems paradoxical that the United States—which has sought to avoid entanglement in foreign political and power struggles during the bulk of its history as an independent nation—today provides the core of the collective military, economic, and political strength of the entire non-Communist world. We have political and security interests, allies, and military forces spread widely over the non-Communist world. The shift of American interests and commitments from the periphery to the center of the world scene has carried with it a concomitant increase in the size and overseas deployment of the Armed Forces necessary to provide for the common defense and support the foreign policy of the United States. As a result, U.S. defense expenditures accounted for over half of the national budget, almost 10 percent of the gross national product, and a net adverse impact on U.S. balance of payments of nearly \$1,700 million in fiscal year 1963.

In the days when our military needs could be met with a stout defense on the seas and a citizens' army, we lived in a world system compatible with our primary national interests. It was based on the nation-state and presided over by British power. The 20th century has seen the old order disintegrate under the impact of two World Wars, the rise of communism supported by a significant power base in both Europe and Asia, the end of the colonial era leading to the creation of a multitude of weak but strident and nationalistic new nations, and rapid technological change—particularly the development of nuclear weapons. During the same period, the United States and the Soviet Union began to emerge as the two leading powers. One major long-term implication of these events was that U.S. national interests would require us to accept and discharge the broad responsibilities of a world power. A second major implication was that the most pressing of our international interests has become the re-creation of a relatively stable world environment—a new equilibrium to replace the one destroyed by the events of the four decades following World War I.

Our conception of the desired world order has been defined by President Kennedy as a peaceful world community of free and independent states, each free to choose its own future and its own system as long as it does not threaten the freedom of others. This would be an environment conducive to our own best national interests and also coincident with the aspirations of every non-Communist country,

neutral or not. Though the military forces of the free world have important responsibilities in its achievement, it depends upon a complex blend of military, political, economic, psychological, and cultural measures.

The Soviet Union has been pressing for its own version of a new world community—a universal Communist world order guided from the U.S.S.R. The law of history as they state it, makes communism the inexorable destiny of all peoples and the Soviet state the messenger of this supposed historical truth. Unity and subordination characterize the Soviet Union's objectives. The leading Communist rulers are not only Marxists, convinced that their system shall inevitably prevail over all others; they are also Leninists, bent upon actively assisting that alleged historical inevitability. They are constantly working in one way or another to replace with their form of tyranny the freedom and diversity found outside their existing empire. Their program is worldwide; it includes the United States. By Khrushchev's own definition, "peaceful coexistence" is an action program intended to extend Communist domination by means short of a self-defeating, general war. Though deterred from initiating general war as long as the free world remains powerful and ready, the Communists favor the threat or even the use of more limited force, when that use can support their ends.

Faced with this sort of a challenge to our broad national objectives, the United States finds itself concerned with the problems of Europe, especially Berlin, Latin America, the Congo, southeast Asia—indeed all areas of confrontation between the Communist and the non-Communist world. Experience has already shown us that a successful defense of America can best be achieved through a "forward strategy" in which the combined power of the United States and other non-Communist nations meets each Communist attempt to advance. Otherwise, the Communists can continue their "salami" tactics of challenging for, and gaining, a little of the free world at a time—no one gain being determinative, yet all of them together adding up to a determinative victory.

The military aspect of the Communist threat was defined by Soviet Premier Khrushchev on January 6, 1961, in three parts: world wars, local wars, and "wars of national liberation." The deterrence or defeat of these three major categories is the chief objective toward which our Armed Forces are directed. Although Premier Khrushchev said he thought general nuclear wars to be unlikely, he uses the threat of the Soviet Union's ever-growing nuclear power in waging his overall campaign against the non-Communist world; and nuclear war can always be sparked by events in which the interests of the great powers are at stake. Our own powerful nuclear posture is no doubt the most important factor in the defense of the non-Communist world. The fact that we can devastate the Soviet Union, even if they should strike first and without warning, strongly inhibits the Communists from a course of action likely to lead to a strategic nuclear exchange. This strategic capability does not come cheaply. In addition to the budgetary aspects of maintaining this powerful nuclear posture, there is a balance-of-payments effect flowing from the need to maintain facilities and men overseas. Obvious examples include: the bases which provide deployment and refueling capability for SAC bombers; bases to provide support for Polaris submarines and strike

carriers; early warning facilities to decrease the vulnerability of our forces from a surprise attack; missile tracking stations; Pacific test facilities.

Premier Khrushchev has observed that, because of the risks of escalation to nuclear war, the possibilities of non-nuclear "local wars" are dwindling. Yet the prospects of this form of aggression are not inconsiderable. Certainly the Communist Chinese show no inhibition in this regard, either in theory or in practice; and the vast manpower of China is an important factor affecting our military requirements for meeting the threat of non-nuclear aggression.

The overseas expenditures required to meet this military threat are related to deployments of U.S. forces in certain frontier areas such as Western Europe, Korea, and Vietnam; bases and installations for tactical aircraft; lines of communication; and a military assistance program to help countries with limited resources assume their proper share of the common defense.

The third type of Communist military threat—which Premier Khrushchev entitles "just wars" or "war of national liberation," and which we characterize as guerrilla warfare, insurgency and subversion—has the Soviet Premier's staunch approval. Greece, Iran, the Philippines, Malaya, Cuba, Vietnam, Laos, are past and present examples of Communist support for this third kind of war, which has a wide geographic, political, ideological, and military range. Civic action programs and training programs to teach indigenous military personnel the techniques of counter guerrilla warfare are examples of overseas expenditures peculiarly attributable to meeting this kind of threat.

These, then, are the three major categories of the military challenge which we must prepare to deter, if possible, and defeat, if necessary. The politico-military strategy available to the United States in meeting the Communist threats is heavily influenced, if not determined, by the characteristics and levels of its military forces and by their deployments. These, in turn, have historically been affected by the intensity with which the United States has regarded the Communist threat. It is always possible to save on defense budgets or on balance-of-payments costs attributable to defense at the cost of adequate military resources to support an optimum strategy. For example, with greater limitations, we might be forced to give up political opportunities which might otherwise be available, or we might be obliged to cut back on the strategy of defending the United States at the frontiers of the non-Communist world, or we might accept increased risks of major war.

Without adopting these alternatives, the Defense Department has been following a vigorous program designed to reduce the net adverse balance of U.S. defense expenditures entering the international balance of payments. First, by increased airlift, by prestockage of equipment and maintenance of standby bases overseas, and by shifting military procurement to the United States, we are improving the balance-of-payments situation without losses in combat capability but with some increases in budgetary costs. Second, there has been the negotiation of joint logistics and other cooperative arrangements with our allies to achieve equal or better military efficiency but with lower overseas dollar expenditures on our part. A third method has been to shift, where appropriate, certain overseas military expenditures to our allies.

Fourth, we are pursuing an active program to encourage other countries to purchase a portion of their military equipment needs in the United States as one means to help offset our defense expenditures abroad.

The general policy has been to build and maintain a balanced defense structure based on U.S. politico-military needs, and we are seeking to do this at the minimum cost, in budgetary and balance-of-payments terms. These forces are providing security and essential support to our foreign policy in an unstable world.

PART II

U.S. DEFENSE BUDGETS AND MANPOWER

Budgets and manpower are two general ways of measuring the amount of investment in defense; and over the past quarter century, these illustrate the protracted, and sometimes costly, process of maintaining national security in an unstable international atmosphere.

The levels of defense spending and of manpower committed to defense just prior to World War II, and between that war and the Korean war, are extraordinarily low when compared with the rest of the years between 1938 and 1963. For example, Department of Defense spending was 1.2 percent of the gross national product (GNP) in 1939 and 4.4 percent in 1949. The level of defense spending in this country for the past decade has been on an historically high level for a period not marked by major wars; and peaks in this spending over the past 25 years show near the conclusion of World War II when the percentage of GNP expended on defense rose to over 37, and during the Korean war, when the peak percentage was 12.1.

Public recognition and acceptance of the gravity and long-term nature of the Communist threat shows in the manpower and budgetary commitments to defense since the mid-1950's. Military manpower strength since 1955 has varied between 2.4 and 2.9 million. Monetary outlays to Department of Defense military functions have risen from \$35 billion in 1955 to the present 1964 estimate of \$51 billion. The 1955 figure came to about 9.4 percent of our GNP and the one for 1964 is estimated at about 8.6 percent. It should be noted that the increase in the defense budget that has taken place in the past 3 years has been matched by increases in our national output, leaving the percentage of GNP devoted to military programs unchanged.

TABLE I.—Federal Government expenditures and gross national product comparison with national defense programs and military functions expenditures

[Fiscal years 1939-64]

Fiscal year	Gross national product	Total Federal Government		National defense programs ¹			DOD military functions ²		
		Expenditures	Percent GNP	Expenditures	Percent GNP	Percent total Government	Expenditures	Percent GNP	Percent total Government
	<i>Billions</i>	<i>Millions</i>		<i>Millions</i>			<i>Millions</i>		
1939.....	\$88.2	\$8,841	10.0	\$1,075	1.2	12.2	\$1,075	1.2	12.2
1940.....	95.7	9,055	9.5	1,498	1.6	16.5	1,492	1.6	16.5
1941.....	110.5	13,255	12.0	6,036	5.5	45.5	5,998	5.4	45.2
1942.....	140.5	34,037	24.2	23,937	17.0	70.3	23,570	16.8	69.2
1943.....	178.4	79,368	44.5	63,159	35.4	79.6	62,664	35.1	79.0
1944.....	202.8	94,986	46.8	76,696	37.8	80.7	75,797	37.4	79.8
1945.....	218.3	98,303	45.0	81,216	37.2	82.6	80,048	36.7	81.4
1946.....	202.8	60,326	29.7	43,226	21.3	71.7	42,044	20.7	69.7
1947.....	223.3	38,923	17.4	14,398	6.4	37.0	13,838	6.2	35.6
1948.....	245.6	32,955	13.4	11,779	4.8	35.7	10,937	4.4	33.2
1949.....	261.6	39,474	15.1	12,926	4.9	32.7	11,573	4.4	29.3
1950.....	263.8	39,544	15.0	13,018	4.9	32.9	11,891	4.5	30.1
1951.....	310.8	43,970	14.1	22,471	7.2	51.1	19,764	6.4	44.9
1952.....	338.8	65,303	19.3	44,037	13.0	67.4	38,897	11.5	59.6
1953.....	359.7	74,120	20.6	50,442	14.0	68.1	43,604	12.1	58.8
1954.....	362.0	67,537	18.7	46,986	13.0	69.6	40,326	11.1	59.7
1955.....	377.0	64,389	17.1	40,695	10.8	63.2	35,531	9.4	55.2
1956.....	408.5	66,224	16.2	40,723	10.0	61.5	35,791	8.8	54.0
1957.....	433.0	68,966	15.9	43,360	10.0	62.9	38,436	8.9	55.7
1958.....	440.2	71,369	16.2	44,234	10.0	62.0	39,070	8.9	54.7
1959.....	466.7	80,342	17.2	46,491	10.0	57.9	41,223	8.8	51.3
1960.....	494.8	76,539	15.5	45,691	9.2	59.7	41,215	8.3	53.8
1961.....	506.6	81,515	16.1	47,494	9.4	58.3	43,227	8.5	53.0
1962.....	539.4	87,787	16.3	51,103	9.5	58.2	46,815	8.7	53.3
1963.....	564.5	94,311	16.7	53,004	9.4	56.2	48,300	8.6	51.2
1964 ³	590-600	98,802	16.7-16.5	55,433	9.4-9.2	56.1	51,000	8.6-8.5	51.6

¹ Budget Bureau "National defense programs" include DOD military functions, military assistance portion of mutual security program, atomic energy development, stockpiling strategic and critical materials, defense production expansion, Selective Service System, and emergency preparedness activities.

² Amounts adjusted for comparability with current coverage of "Military functions."

³ Estimates based on fiscal year 1964 Federal budget request.

NOTE.—GNP is based on current market prices.

Source: Bureau of the Budget and OSD.

TABLE II.—Total active duty military personnel 1939-63 and percentage of U.S. population in active military service

[Figures represent actual active duty count as of dates shown]

	Total number of military personnel	Percent of U.S. population		Total number of military personnel	Percent of U.S. population
June 30, 1939.....	334,473	0.3	June 30, 1952.....	3,635,912	2.3
June 30, 1940.....	458,365	.3	June 30, 1953.....	3,555,067	2.2
June 30, 1941.....	1,801,101	1.3	June 30, 1954.....	3,302,104	2.0
June 30, 1942.....	3,858,791	2.8	June 30, 1955.....	2,935,107	1.7
June 30, 1943.....	9,044,745	6.6	June 30, 1956.....	2,806,441	1.6
June 30, 1944.....	11,451,719	8.2	June 30, 1957.....	2,795,798	1.6
June 30, 1945.....	12,123,455	8.6	June 30, 1958.....	2,600,581	1.5
June 30, 1946.....	3,030,088	2.1	June 30, 1959.....	2,504,310	1.4
June 30, 1947.....	1,582,999	1.1	June 30, 1960.....	2,476,435	1.3
June 30, 1948.....	1,445,910	1.0	June 30, 1961.....	2,483,771	1.3
June 30, 1949.....	1,615,360	1.0	June 30, 1962.....	2,807,819	1.5
June 30, 1950.....	1,460,261	.9	June 30, 1963.....	2,699,677	1.4
June 30, 1951.....	3,249,455	2.1			

NOTE.—The greatest strength reached in World War II was 12,124,418 on May 31, 1945. The low between World War II and Korea was 1,389,728 on Mar. 31, 1948.

PART III

DEPLOYMENT ABROAD

History shows a correlation between our recognition of the intensity of external threats to our national interests and the number of U.S. military personnel deployed overseas.

In 1938, the American Defense Establishment in uniform amounted to slightly more than 300,000 men and women, most of whom were based in the United States. In less than 7 years it grew by a factor of nearly 40, to a peak of 12,124,418 on May 31, 1945. This massive combat force, deployed across the seas and coupled with those of our Allies, defeated the Axis Powers in the greatest war of history.

Following World War II, these forces were rapidly demobilized to less than 1.4 million men and women by March 31, 1948. In Europe and the Far East, the Armed Forces provided security and administrative services in former enemy territory and in liberated countries, until civil authority could be legally constituted. In June 1946, the Army and Air Corps in the European theater amounted to 340,000, the vast majority of whom were engaged in occupation duties in Germany and Austria. By midyear 1949, 3 months before the Federal Republic of Germany was established, forces in Germany had dropped to 82,000 and less than 10,000 in Austria. In Japan, similar occupation functions were the responsibility of 155,000 Army and Air Corps troops in June 1946, as well as the 23,000 troops in the Ryukyus. Twenty-four thousand marines were deployed in North China during this same period.

At the outbreak of the Korean war in June 1950, Army forces in Japan totaled about 83,000. Total U.S. Army forces in the Far East amounted to slightly over 111,000, including those in Korea, the Philippines, and the Marianas. Part of the 7th Fleet was at Okinawa and the remainder was in the Philippines. The Air Force in the Pacific consisted of nine wings, with a strength of about 35,000 officers and men on June 30, 1950, and was the largest U.S. Air Force aggregation outside the continental United States.

To meet the Korean attack, it was necessary to draw the occupation forces from Japan and eventually to deploy large forces from the continental United States. By September 1950, the four divisions in Japan had been dispatched to Korea, along with the 1st Marine Division and the 2d Infantry Division from the United States. Newly activated National Guard divisions were deployed to Japan to replace units sent to Korea.

By the time of the Korean truce on July 27, 1953, Army forces in the Far East totaled 373,933, and the Far East Air Force had more than tripled, with a strength of 105,000 officers and men and a unit count of 19 wings composed of 69 squadrons. The 3d Marine Division had been brought to full strength by this time and was deployed in the Far East. An additional division (3d Infantry) and a regimental combat team from the 11th Airborne had been deployed to Korea from the United States. The 7th Fleet, with 125 combatant vessels, including 6 aircraft carriers, was deployed in the Far East.

Our military commitments in Europe following World War II are the outgrowth of deteriorating relations with the Soviet Union. Soviet reluctance after World War II to withdraw from Azerbaijan,

followed by the Greek civil war of 1945, the Communist takeovers in Eastern Europe in the next 3 years and the Berlin blockade of 1948 provided cumulating proof that resistance to the aggressive purposes of the Communists required a collective military capability. On April 4, 1949, 12 nations from Western Europe and North America (later to be joined by 3 others) entered into the North Atlantic Treaty for their common defense.

The bulk of the American forces in Europe at the time of signature of the pact were earmarked for NATO purposes. The number of Army divisions so designated has remained at five since late 1951.¹ The U.S. Army combat and supporting forces strengths in Europe varied generally downward from 267,662 on June 30, 1954, to 230,116 on June 30, 1961. Deployments from the continental United States as a result of the Berlin crisis commencing in late 1961 raised Army strength in Europe to more than 270,000 by the end of June 1962. The U.S. 6th Fleet, with Marine forces embarked, has been deployed in the Mediterranean since shortly after World War II.

Meanwhile, the number of major ground force units deployed in the Far East underwent a marked decrease following the end of hostilities in Korea. The level of U.S. Army divisions in Korea after the armistice was reduced from seven to two, the present level. The last Army combat division was returned from Japan in 1957. One Marine division and one Marine aircraft wing and an airborne battle group remain deployed in the Far East, and an Army division and a Marine brigade are based in Hawaii.

The threat of Communist aggression over the past 18 years and the specific crises associated therewith—Iran, Greece, Turkey, the Berlin blockade, Korea, Lebanon, Quemoy-Matsu, Vietnam, the Congo, the Berlin wall, Thailand, and Cuba—have demanded the deployment of U.S. forces in many parts of the globe, sometimes to stabilize, sometimes to fight. In the broadest sense, these deployments have resulted from U.S. efforts to develop a free international community dependent on a hard core of strong and developed nations, willing to orchestrate their resources in defensive and constructive tasks beyond their borders, and to draw, along with the less developed nations, common ties for the common good.

The strategic rationale behind present overseas deployments is linked in a quite specific sense to the regional interests and objectives of the United States and to areas where free societies may be in jeopardy.

Western Europe has continued to be an area of extraordinary importance to our national interest, and we are committed to help defend that area virtually on the same terms as U.S. territory. Because Western Europe represents the most important center of free world resources, its loss would gravely endanger U.S. security and would drastically alter the power equilibrium in the world.

The arc from Iran to Korea represents an area where the elements of power are in precarious balance. Here, the rising threat is Red China, whose power will be a source of danger for many years to come. And this power may grow—especially when Communist China comes into possession of nuclear weapons. The loss in this area of one or

¹ The figure of six instead of five divisions is sometimes used as a matter of convenience in order to include the additional combat units which are the approximate equivalent of a division.

more nations belonging to the free community would have serious effects not only in terms of the country immediately affected but for an entire region. The loss of South Korea, for example, would endanger Japan. The loss of Vietnam or Thailand could threaten the whole of southeast Asia and the independence of India. The loss of Iran similarly would jeopardize the Middle East.

Also, although not so directly exposed to aggression, the security of the United States is affected by what happens in Africa and Latin America. Our sensitivity to, and the dangers stemming from aggression in Latin America have been demonstrated in the case of Cuba. Geographic proximity, historical association and economic interest all demand strong support for the security of these areas. The independence of the region and the development of conditions conducive to progress are vital to U.S. security.

The nature and breadth of our security interests and deployments abroad are illustrated by the series of alliances in which the United States holds membership or to which it lends support. These include NATO in Europe, the Central Treaty Organization in the Middle East, the Southeast Asia Treaty Organization, the Australia-New Zealand-United States pact, and bilateral security pacts with Japan and the Republics of Korea, China, and the Philippines, and the Rio Treaty with our Latin American neighbors.

Forward deployments provide the clearest possible indication, both to the Allies and to potential antagonists, of the determination of the United States to defend its own national security at the frontiers of the non-Communist world, to honor its commitments, and to respond appropriately to aggression.

PART IV

THE EUROPEAN DEFENSE EFFORT

In the course of their rapid economic recovery following World War II, the European Allies of the United States have increased their defense expenditures. Yet, in many cases, the percentage of their GNP flowing into defense has remained at a relatively low level or has declined. And our NATO Allies have consistently fallen short of stated military force level requirements. The United States, on the other hand, has not only increased its absolute investment in defense over the last 8 years but has also devoted a percentage of GNP to national defense programs which has remained significantly higher than that of any other member of NATO.

There is, of course, no pat formula by which any military alliance can determine who contributes what and how much. While there is a general acceptance of the proposition that the wealthier members of the alliance should contribute a larger share than the poorer, there is no agreed formula for defense efforts in NATO, nor is there likely to be. This has been part of the dialog among NATO members for some time, and the problem of burden sharing is, though perhaps understood, not likely to be solved in the foreseeable future.

There are several ways to measure comparative efforts. One measure of U.S. and European contributions to NATO is the percentages of GNP which are devoted to defense. In 1962, the GNP of NATO members (other than the United States) totaled, at factor

cost, \$309 billion. The U.S. GNP, again at factor cost, was about \$507 billion. On the other hand, the defense budgets of the other NATO members amounted to about \$18 billion as against \$54 billion for the United States. The U.S. share of GNP devoted to defense was about 4 percentage points higher than the average of the other NATO nations.

While GNP's have been rising rapidly, the recent trend in Europe has been to spend a declining percent of the GNP on defense. The 1956 average for NATO, excepting the United States, was 6.7 percent. In 1962, it was 6 percent. Exceptions to this rule are West Germany, Denmark, Norway, Portugal, and Turkey.

The United States is continuing to encourage NATO nations to make a greater investment in defense. We pointed out a year ago that if other members of NATO would meet their main shortfalls in NATO goals their defense budgets would be increased by about 20 percent during the next 5 years. The past year has seen an increase in these non-U.S. budgets of about one-third this amount (about \$1.2 billion), with most of the increase occurring in the Federal Republic of Germany.

TABLE III.—Comparative defense efforts, NATO nations

Country	Calendar year 1962 GNP (factor cost, billions of U.S. dollars) ¹	Calendar year 1962 defense expenditures (millions of U.S. dollars)	Percent of (factor) GNP for defense		Men under arms, 1962	
			1962	1956	Percent of population	Total number (thousands)
European: ²						
Belgium.....	12.2	416	3.4	3.6	1.2	107
Denmark.....	6.3	223	3.5	3.4	1.0	47
France.....	56.7	4,206	7.4	9.2	2.0	921
Germany.....	72.1	4,094	5.7	4.3	.7	399
Greece.....	3.3	168	5.1	7.1	1.9	163
Italy.....	33.4	1,351	4.0	4.5	.7	367
Luxembourg.....	.46	7	1.6	2.1	1.2	2
Netherlands.....	11.9	596	5.0	6.3	1.2	142
Norway.....	4.6	191	4.2	4.0	.8	30
Portugal.....	2.4	211	8.8	4.5	1.4	128
Turkey.....	5.4	330	6.1	5.2	1.6	466
United Kingdom.....	69.0	5,001	7.2	8.8	.8	425
Non-European:						
Canada.....	31.0	1,646	5.3	7.1	.7	131
United States.....	506.7	54,452	10.7	10.8	1.5	2,704

¹ GNP shown in this table is based on factor cost. This method of computation is used in NATO and gives figures significantly different from those arrived at through the method of computation normally used by U.S. economists. GNP at factor cost does not include indirect taxes but does include business subsidies. It gives a more favorable impression for European countries in that GNP shows as a smaller figure and defense expenditures as a greater percentage of GNP.

² Iceland is not included because it does not maintain a defense force and does not contribute funds to European infrastructure.

PART V

RECENT DEVELOPMENTS IN U.S. DEFENSE PROGRAMS

When President Kennedy assumed office in 1961, he charged the Secretary of Defense with developing the force structure necessary to meet strategic requirements, without regard to an arbitrary or pre-determined budgetary ceiling, and with procuring this structure at the lowest possible cost.

The process of determining the balance between the various goals of the economy, the competing claims on the budget of national security

and other Government programs is based on a broad and searching analysis of strategic requirements, and provision of these forces within the resources and growth interests of the national economy. The United States has limited resources. It cannot do everything in a security sense that is desirable, and, for technological reasons cannot do some things at all.

Nevertheless, the result of this process is an Armed Force which enables the President to employ a strategy of great flexibility against threats ranging from local subversion to nuclear world war. One of the prime purposes of this strategy is to avoid a course of action that would lead to general war, and yet achieve all important U.S. objectives. The Department of Defense expenditure estimate for this force (military functions only) as included in the 1964 budget request, was about \$51 billion, or about 8.6 percent of the GNP.

The aim over the past 3 years has been to build a force structure permitting a wider range of options, but not obliging the United States to choose in advance which option would be exercised. The approach to this strategy is illustrated by Secretary McNamara's remarks before the fellows of the American Bar Foundation in February 1962:

Nuclear and non-nuclear power complement each other in our military forces and within the NATO alliance, just as together they complement the nonmilitary instruments of policy. Either without the other is, overall, not fully effective * * * if we strengthen one and not the other, part of the effort is wasted. Our policy is aimed at achieving the best balance of military capabilities over the entire range of potential conflict, in the various areas of the globe where the free world has vital interests, and over the years as far ahead as we can reasonably plan. I firmly believe that the non-nuclear buildup will, by improving and expanding the alternatives open to the free world, reduce the pressures to make concessions in the face of Soviet threats.

An appropriate way to summarize the present and planned force structure and the financial requirements supporting a strategy of multiple options is to review several of the pertinent parts of the U.S. military program as it was described in connection with the presentation of the 1964 defense budget. In the course of developing this force structure, a new and more effective means of determining requirements and allocating resources to specific defense goals was introduced. Sometimes known as the program package approach, the forces and the budget are divided into nine major military programs, as follows: (1) Strategic Retaliatory Forces, (2) Continental Air and Missile Defense Forces, (3) General Purpose Forces, (4) Airlift-Sealift Forces, (5) Reserve and Guard Forces, (6) Research and Development, (7) General Support, (8) Civil Defense, and (9) Military Assistance. Several of these programs are discussed below.

The strategic retaliatory forces are designed to carry out the long-range strategic mission and to carry the burden in general nuclear war. In this force in August 1963, there were more than 500 missiles (including Titan, Atlas, Minuteman, and Polaris), SAC bombers on air alert and over 500 SAC bombers on quick reaction alert. A rapidly increasing portion of this force will consist of hardened and dispersed ICBM's and submarine-based Polaris missiles, all with a high probability of survival under nuclear attack. The program cost of the strategic retaliatory forces currently is estimated at \$7.2 billion for fiscal year 1964, compared with \$8.5 billion for fiscal year 1963 and \$9.1 billion for fiscal year 1962.

The continental air and missile defense forces include those weapons systems, warning and communication networks, and ancillary equipment required to detect, identify, track and destroy unfriendly forces approaching the North American Continent. The requirements for these forces are related to strategic retaliatory forces, inasmuch as the latter, if successful in carrying out their mission, would reduce the weight of the follow-on attack upon the United States.

The weight of the strategic threat against the United States continues to shift from manned bombers to ICBM's and submarine-launched missiles, although the balance in megatonnage still lies with the manned bombers. The most difficult problem confronting the continental air and missile defense forces is defense against ICBM attack. All three sites of the ballistic missile early warning system (BMEWS) are now operating, one at Clear, Alaska, one at Thule, Greenland, and one at Fylingdales Moor, England. A second difficult problem is defense against submarine-launched missiles. To meet the requirements of continental air and missile defense, the 1964 program cost currently is estimated at \$1.9 billion, compared with \$1.9 billion for fiscal year 1963 and \$2.1 billion for fiscal year 1962.

The general purpose forces include most of the Army's combat and combat-support units, nearly all Navy units, all Marine Corps units, and the tactical units of the Air Force. These are the elements which, with support from airlift and sealift forces and other elements, perform the entire range of operations other than strategic nuclear actions. The number of combat ready divisions in the Army has increased from 11 to 16 since 1961. By the end of fiscal year 1964, it is planned to have all of the 16 divisions reorganized so as to increase organizational flexibility, nonnuclear firepower, and tactical mobility. There will be five mechanized, six infantry or mechanized infantry, three armored, and two airborne divisions.

In addition, the Army has reorganized and increased the strength of its special forces units, which constitute the primary specialized counterinsurgency capability. There will be six special forces groups with a total strength of about 5,600 men. With respect to the Army Reserve components, there will be a priority force consisting of six divisions and supporting forces, plus additional units to round out the Active Army. This force will be manned at 80 percent or more of its authorized strength, and will have a readiness objective of 8 weeks or less after mobilization.

In the general purpose forces, a strength of 836 ships in the Navy is planned. In addition to the ballistic missile nuclear submarine forces, this will include a balanced spread in carrier, antisubmarine, mine warfare, and amphibious shipping capable of being task organized for any contingency. The increase in amphibious lift has been significant and a continuation of this program is planned. About 640 new aircraft of all types were requested for the Navy and Marine Corps during fiscal year 1964.

The present Marine Corps of three divisions and three aircraft wings, with supporting units and manned by 190,000 marines, will be maintained during fiscal year 1964. The Marine Corps Reserve has been realigned to fulfill the requirement for a rapidly mobilizable fourth division and air wing team.

The general purpose forces of the Air Force include tactical fighters, bombers, and reconnaissance aircraft, tactical missiles and interceptor

aircraft deployed overseas. The tactical fighter refueling mission is being assumed by a tanker force centrally managed by SAC. For Air Force general purpose programs, fiscal year 1964 procurement plans call for about 440 tactical type aircraft. The principal concern in this area during the last 2 years has been the need to build adequate air support for Army ground forces so that they could engage, if necessary, in a sustained non-nuclear conflict. The tactical fighter forces have been built to 21 wings, 5 wings more than there were in 1961.

For the general purpose forces a total program cost of \$18.3 billion currently is estimated for fiscal year 1964. This is compared with \$18.1 billion for fiscal year 1963 and \$17.5 billion for fiscal year 1962.

The airlift and sealift forces include both Military Air Transport Service transports and Air Force Tactical Air Command troop carrier aircraft. The sealift includes troop ships, cargo ships, and tankers operated by the Military Sea Transport Service and the so-called forward floating bases. In addition to the increase in amphibious lift mentioned above, the C-141 air transport program will increase MATS ton-mile capability fourfold.

The concept of airlifting large numbers of troops to points where equipment and weapons are prepositioned was tested in October 1963, when a division was airlifted to Europe, picked up its prepositioned heavy equipment there and deployed in a short exercise.

For the airlift and sealift forces a total of \$1.4 billion program cost currently is estimated for fiscal year 1964, as compared with \$1.4 billion for fiscal year 1963 and \$1.2 billion for fiscal year 1962. By increasing our capability for rapid deployment of combat forces from central reserves in the United States and elsewhere, we are able to maintain greater flexibility of forces and to increase overseas combat capabilities without adding to expenditures abroad.

The budgetary requests for Reserve and National Guard forces, research and development, general support, civil defense and other aspects of the defense program for 1964, are summarized in table IV.

While there has been an increase of some \$8.7 billion in the annual level of total obligational authority required in the course of revising the defense structure, the percentage of gross national product absorbed in this effort has remained about constant for the past 3 years.

The breadth of alternatives made possible under the current level of expenditures is illustrated in the Cuban crisis of 1962. The cutting edge of U.S. power in this case was a relatively small part of our forces. But behind these stood a full and flexible array of power, including airborne SAC bombers and ready ICBM's, Polaris submarines under the seas, armed tactical aircraft, Army airborne troops and seaborne marines ready to invade, and deployed attack aircraft carriers and missile ships.

Looking to the future, the United States must maintain a lead in strategic nuclear capabilities so as to be able to operate other forces under an umbrella of a strong strategic force. By maintaining adequate general purpose forces in a high state of readiness, we can significantly decrease the likelihood of either large-scale non-nuclear conflict or localized nuclear war. The free world will continue to be faced with conflicts at the lower end of the military spectrum, for which our programs and training in counterinsurgency and antisubversion tactics will be important. In addition, crisis deployments similar to Lebanon and Thailand, and show-of-force operations short of fighting, will

undoubtedly be necessary to support U.S. foreign policy. U.S. programs under the present strategy, force characteristics and force levels should be better able than in the past to cope with the full range of military threats to our security.

TABLE IV.—Financial summary, military programs ¹

(In billions of dollars)

	Fiscal year 1961, actual	Fiscal year 1962, original	Fiscal year 1962, final	Fiscal year 1963 (pre- liminary)	Fiscal year 1964 budget estimate ²
1. Strategic retaliatory forces.....		7.6	9.1	8.5	7.2
2. Continental air and missile defense forces.....		2.2	2.1	1.9	1.9
3. General purpose forces.....		14.5	17.5	18.1	18.3
4. Airlift and sealift forces.....		.9	1.2	1.4	1.4
5. Reserve and Guard forces.....		1.7	1.8	2.0	2.0
6. Research and development.....		3.9	4.3	5.5	5.7
7. General support.....		12.3	12.7	13.8	14.5
8. Civil defense.....			.3	.2	.3
9. Military assistance.....		1.8	1.8	1.6	1.6
Proposed legislation for military com- pensation, etc.....					.9
Total obligational authority.....	46.1	44.9	51.0	52.8	53.8
Less financing adjustment.....	3.0	1.2	1.6	1.7	2.0
New obligational authority.....	43.1	43.7	49.4	51.1	51.8
Adjustment to expenditures.....	+1.6	+1.0	-1.2	-1.1	-.2
Total expenditures.....	44.7	44.7	48.2	50.0	51.6
Total obligational authority by depart- ment and agency:					
Army.....	10.5	10.6	12.8	12.2	12.8
Navy.....	12.8	12.5	14.9	15.2	15.0
Air Force.....	20.1	18.7	20.0	20.9	20.2
Civil defense.....			.3	.2	.3
Defense agencies.....	.3	.4	.3	1.8	1.9
Retired pay.....	.8	.9	.9	1.0	1.1
Military assistance.....	1.5	1.8	1.8	1.6	1.6
Proposed legislation.....					.9
Total.....	46.1	44.9	51.0	52.8	53.8
Memo: Recently enacted and proposed increases in compensation included above:					
Military.....				.1	1.2
Civilian.....				.2	.3
Total.....				.3	1.5

¹ Totals may not add due to rounding.² Adjusted to reflect congressional action, DOD Appropriation Act, 1964, as of Oct. 23, 1963.

³ The 1st full year expenditure for items covered by new legislation is estimated at \$1,200,000,000. This figure excludes \$285,000,000 annual increase for basic allowance for quarters which became effective Jan. 1, 1963. It also excludes an increase of \$230,000,000 per year in the Government's "unfunded" cost of military retirement resulting from increases in active duty pay. Therefore the total average annual cost of all pay increases, proposed to be effective in calendar year 1963 is approximately \$1,715,000,000.

⁴ Excludes nuclear warhead cost.

⁵ The amounts shown are for funds to be expended during the indicated years and represent the cost of past service on a "cash basis." The total "accrued" costs for past service on July 1, 1963, will be \$49,900,000,000 on the basis of existing pay rates and \$55,200,000,000 on the basis of proposed pay rates. An additional \$1,880,000,000 will accrue during fiscal year 1964 on the basis of existing pay rates, or \$2,100,000,000 on the basis of proposed rates.

PART VI

THE MILITARY ASSISTANCE PROGRAM

Like deployments of U.S. military forces abroad, the military assistance program is designed to implement a strategy of opposing potential aggression wherever it might threaten. Military assistance augments the conventional capabilities of allies and others throughout the world, thus increasing the variety of responses available to the free world to meet various types of internal and external aggression.

Military assistance and deployments of U.S. forces are complementary in that each is a means to increase free world military capabilities. U.S. policy calls for the use, where possible, of military assistance to improve friendly foreign forces, rather than additional deployments of U.S. forces to supplement them.

Shortly after the end of World War II, both Greece and Turkey were subjected to strong pressures from the U.S.S.R. Both approached the United States for assistance in maintaining their territorial integrity and internal security. To meet these needs, President Truman, in March 1947, called for an appropriation of \$400 million for military and economic aid to these two countries. Two years later the program was expanded to authorize military assistance to free nations throughout the world whose security was vital to the United States and which could not fully support their own defense requirements.

The purpose of military assistance is stated in the Foreign Assistance Act of 1961:

In enacting this legislation, it is therefore the intention of the Congress to promote the peace of the world and the foreign policy, security, and general welfare of the United States * * * by facilitating arrangements for individual and collective security * * * and creating an environment of security and stability in the developing and friendly countries essential to their more rapid social, economic, and political progress.

The military assistance program has been a key instrument of national security policy in many parts of the world. As Europe has become better able to support its own forces, focus has shifted to the Far East and South Asia. The present concentration is apparent in the fact that about 70 percent of the program is provided to nine key countries—Greece, Turkey, Iran, Pakistan, India, Thailand, and the republics of Vietnam, Korea, and China—which maintain a total military strength of over 3.5 million men on the border of the Sino-Soviet bloc. These nine countries maintain more men under arms than the United States. Such a large contribution to the security of the non-Communist world, as a whole, would not be possible without the U.S. contribution which costs less than \$1 billion per year.

In both absolute expenditures and in balance-of-payments terms, it is far less costly to support this fighting power than it would be to make an equivalent commitment of U.S. forces. It is estimated that pay, allowances, subsistence, and clothing alone cost the United States an average of approximately \$4,300 per man, per year for its own troops. The same cost for a soldier in these nine countries averages less than 10 percent of that figure.²

Programs outside of the nine key countries on the border of the Sino-Soviet bloc account for 30 percent of military assistance costs. These expenditures also contribute significantly to the attainment of our national objectives. These programs, particularly those for underdeveloped nations in Latin America, Africa, and southeast Asia are oriented toward internal security and civic action programs. They are designed to manifest U.S. interest in the security and well-being of these countries, and to assist in maintaining stability in volatile situations that threaten the orderly and peaceful emergence of these nations.

² While the per capita cost of the U.S. defense budget to every American man, woman, and child has been computed at \$258 annually, the comparable cost for the entire military assistance program in 1963 was about \$7.75. Moreover, the military assistance program represented only about 3 percent of the total defense budget.

Military assistance funds are also used to provide the U.S. share of the costs of NATO infrastructure and the operating expenses of international headquarters. The completion of commitments made to our European NATO Allies will require about 10 percent of the military assistance program proposed for fiscal year 1964 and decreasing amounts thereafter. The administrative expenses for military assistance are \$25 million per year, and an equal amount of new obligational authority is used for credit financing of purchases of military equipment and training from the United States. In addition to these programs, military assistance provides the funds required to insure the continued availability of many facilities used by U.S. forces throughout the world.

One of the dividends received from the military assistance program accrues from the training of foreign military personnel and the contacts between these personnel and U.S. officers and men. More than 164,000 foreign nationals have been trained in the United States since the beginning of the program. Overseas, another 50,000 have been trained at U.S. installations, and countless thousands have been trained in their own countries by U.S. teams and technical representatives. Many of these individuals are handpicked by their governments and are potential senior leaders of their military forces.

Regarding balance of payments, military assistance expenditures affecting this problem are relatively small, inasmuch as the bulk of the military assistance program funds are used to procure U.S.-made military equipment which is granted to foreign forces. This is discussed more fully in the following section.

TABLE V.—Percentage distribution of military assistance programs (grant aid), fiscal years 1950-64

	Proposed, 1964	1963	1962	1961	1960	1959	Cumulative, 1950-58
Europe.....	15	15	20	28	38	30	61
Africa.....	2	2	2	1	1	1	(1)
Near East.....	28	28	23	23	16	23	14
Far East.....	44	44	46	41	38	38	21
Latin America.....	5	5	4	3	3	2	1
Nonregional.....	6	6	5	4	4	6	3
NATO.....	32	31	35	41	45	40	70

¹ Less than 0.05 percent.

TABLE VI.—Grant aid program—Chargeable to appropriations, deliveries by fiscal years

[Millions of dollars]

	Estimate, fiscal year 1963	Fiscal years												
		1962	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951	1950
Total.....	1,801.4	1,426.7	1,344.1	1,697.1	2,050.3	2,324.8	2,077.9	2,920.0	2,395.6	3,295.9	4,158.8	1,481.2	980.4	55.7
Europe.....	450.3	411.6	538.9	796.0	694.8	906.3	1,344.4	1,738.9	1,496.6	2,168.7	2,845.0	1,013.9	604.6	37.1
Belgium.....	28.0	18.8	9.5	22.0	9.1	65.2	.9	193.1	106.5	223.0	361.5	109.4	60.0	3.4
Denmark.....	22.8	15.0	33.4	36.5	27.2	23.6	43.0	33.8	72.8	78.3	79.9	44.3	25.5	3.9
France.....	14.3	33.8	14.4	68.8	104.8	133.8	226.4	442.1	499.1	658.2	1,107.9	485.5	346.2	15.5
Germany.....	.3	1.5	16.0	91.4	49.6	158.0	489.1	94.4						
Italy.....	70.0	83.7	138.0	101.7	96.6	102.5	158.3	281.7	201.6	344.2	416.6	95.5	71.5	2.6
Luxembourg.....	(¹)	(¹)	.1	.5	.8	1.0	.6	.3	1.0	2.5	1.0	.1	.1	.2
Netherlands.....	16.3	12.8	30.3	49.4	22.8	72.5	68.7	206.4	157.3	202.4	172.6	100.5	34.4	4.6
Norway.....	38.7	24.9	13.2	34.1	40.1	58.0	44.2	89.4	49.1	101.5	123.1	50.9	44.2	4.3
Portugal.....	11.2	4.4	3.4	10.1	16.7	18.9	19.3	43.8	53.0	33.4	71.5	10.2	.4	
Spain.....	31.8	27.5	35.9	49.1	51.6	48.2	76.5	65.4	39.0	23.2				
United Kingdom.....	11.2			116.5	133.8	22.6	87.9	125.6	106.5	170.5	154.8	37.9	22.3	2.6
Yugoslavia.....				2.9	34.1	17.1	55.1	136.7	230.7	160.6	60.5			
Europe area program.....	205.7	168.5	233.7	216.3	142.9	168.1	112.0	107.5	74.7	102.3	194.0	18.2		
Africa.....	27.2	18.1	11.6	8.4	5.6	9.9	4.8	4.0	.9	3.9				
Cameroon.....	(¹)	.2												
Congo (Léopoldville).....	.2	.1												
Dahomey.....	(¹)	.1												
Ethiopia.....	9.0	10.9	6.0	7.0	5.2	8.8	4.7	4.0	.9	3.9				
Ghana.....	.1	(¹)												
Ivory Coast.....	.1	.1												
Liberia.....	2.1	.4	.3		(¹)		.1							
Libya.....	1.1	1.3	.3	.9	.3	1.1								
Mali.....	.7	.7	.1											
Niger.....	(¹)	.1												
Nigeria.....	.2	(¹)												
Senegal.....	1.5	.1												
Upper Volta.....	(¹)	.1												
Africa area program.....	12.1	4.1	4.9	.5	.1									
Near East-south Asia.....	361.0	264.6	244.8	360.9	483.9	592.6	365.7	370.4	256.5	359.9	300.4	167.3	136.7	9.5
Afghanistan.....	1.2	.6	.5	.2	.2	(¹)								
Greece.....	62.0	34.9	42.8	91.4	81.2	135.1	62.4	95.6	59.2	95.2	121.3	59.3	83.0	8.5
India.....	30.0													
Iran.....	58.1	33.3	49.2	89.1	90.9	73.0	39.0	23.6	17.5	26.5	27.3	5.9	10.7	

Iraq.....	.1	(1)	(1)	.1	.1	21.3	13.1	6.1	5.4						
Jordan.....	4.3	2.6	1.9	2.9	2.2	8.5									
Lebanon.....	.2	.2	.9	.2	3.6	1.3	2.1								
Syria.....	(1)														
Turkey.....	135.7	156.4	85.9	92.6	196.4	249.4	152.4	191.3	161.5	238.2	151.8	102.1	43.0	1.0	
Yemen.....	(1)														
NESA area program.....	69.4	36.6	63.6	84.4	109.3	104.0	96.7	53.8	12.9						
Far East.....	763.2	596.3	552.6	575.3	724.6	734.9	610.0	711.4	485.8	618.2	630.8	204.5	140.3	1.9	
Cambodia.....	10.3	8.7	5.4	2.9	3.9	7.9	20.9	23.7							
China, Republic of.....	132.3	84.4	84.4	135.9	232.7	149.6	169.8	345.1	297.1	154.3	173.8	38.5	9.5		
Indochina.....		.2	.2	2.4	2 6.7	2 11.3	2 129.8	2 230.7	71.4	400.0	362.8	140.5	104.3	.3	
Japan.....	49.1	74.0	66.9	85.8	131.5	130.9	111.1	97.9	39.3	.5					
Korea.....	199.4	136.9	192.2	187.1	190.5	331.1	258.8	201.5	20.2	3.4	3.7	.8	10.8	.1	
Laos.....		37.1	33.4	13.4	7.5	5.4	4.3	27.4							
Philippines.....	23.9	20.5	23.6	19.5	20.5	21.1	23.7	33.3	15.7	12.0	34.5	11.2	6.9	1.5	
Thailand.....	71.6	39.1	23.9	20.1	18.0	19.7	26.2	43.4	40.8	38.9	55.8	12.0	4.5		
Vietnam.....		144.0	65.0	70.9	41.9	53.2	110.5	167.3							
Far East area program.....	276.5	51.6	57.6	40.1	84.8	27.3	14.5	2.5	1.3	.1	.2	1.5	4.3	(1)	
Latin America.....	63.6	54.3	45.0	32.3	31.5	45.6	27.1	23.5	31.8	34.5	11.2	.2			
Argentina.....	1.5	1.2	.5	.1											
Bolivia.....	1.6	2.2	.4	(1)	.3	.1									
Brazil.....	16.9	19.3	23.9	18.2	11.7	18.2	8.3	7.7	12.7	17.6	3.0				
Chile.....	10.2	7.9	4.0	2.7	5.4	6.7	2.7	2.6	4.0	6.7	1.3				
Colombia.....	8.4	5.8	3.2	2.7	2.5	2.6	2.3	2.4	3.7	2.5	3.4	(1)			
Costa Rica.....	.7	.1	.1	(1)											
Cuba.....		.1	.1	.2	.4	3.0	2.0	1.7	1.6	1.1	.4				
Dominican Republic.....	2.1	2.2	(1) (2)	.2	.7	.9	1.2	1.2	1.9	(1)	2.3	.9	.1		
Ecuador.....	2.8	2.3	2.0	2.5	1.6	2.5	1.7	1.8	1.8						
El Salvador.....	.6	.6	.4	(1)											
Guatemala.....	2.0	1.3	.4	.2	(1)	.1	.3	.3							
Haiti.....	.4	.5	.6	.4	(1)	1	.7	.6							
Honduras.....	1.1	1.5	.3	.1	.1	(1)	.1	.1	.2	.2					
Mexico.....	.4	.3	.1												
Nicaragua.....	1.5	1.0	.6	.2	.1	.2	.2	.1	.3	.2					
Panama.....	.8	.3	.1												
Paraguay.....	.9	.2	.2												
Peru.....	6.7	4.6	4.4	2.5	4.1	5.2	3.4	2.3	3.6	3.5	2.2	.1			
Uruguay.....	2.5	3.4	2.9	1.4	4.0	5.5	3.7	2.5	1.6	.4					
Venezuela.....	1.3	.5	(1)												
Latin America area program.....	1.2	1.1	1.0	.9	.6	.5	.5	.2	.4						
Nonregional.....	136.1	81.8	2 48.8	2 75.8	109.9	35.5	2 274.1	71.8	124.0	110.7	371.4	95.3	98.8	7.2	

¹ Less than \$50,000.

² Negative amount.

NOTES.—Totals are sums of unrounded amounts, hence may vary from totals of rounded amounts. Values which remain classified because of intergovernmental agreement or because of their sensitive nature are included in the area programs regional lines.

TABLE VII.—NATO defense¹ expenditures and U.S. military assistance

[Billions of dollars]

Calendar year	MAP deliveries	Country defense expenditures ¹	Calendar year	MAP deliveries	Country defense expenditures ¹
1950.....	0.3	5.9	1957.....	1.4	12.3
1951.....	.8	8.2	1958.....	1.0	12.1
1952.....	2.0	11.1	1959.....	1.0	13.5
1953.....	2.8	11.4	1960.....	.8	14.3
1954.....	1.9	10.8	1961.....	.5	15.2
1955.....	1.5	10.8	1962.....	.6	17.3
1956.....	1.8	11.7			

¹ Excludes the United States and Canada.

TABLE VIII.—MAP in relation to major U.S. national security expenditures

[Dollar amounts in billions]

Fiscal year	Total	MAP	Percent	Fiscal year	Total	MAP	Percent
1953.....	\$50.4	\$4.0	7.9	1959.....	\$46.5	\$2.4	5.2
1954.....	46.9	3.6	7.7	1960.....	45.7	1.6	3.5
1955.....	40.6	2.3	5.7	1961.....	47.5	1.5	3.2
1956.....	40.6	2.6	6.4	1962.....	51.1	1.4	2.7
1957.....	43.4	2.4	5.5	1963 estimate.....	53.0	1.8	3.4
1958.....	44.2	2.2	5.0	1964 estimate.....	55.4	1.5	2.7

PART VII

NATIONAL DEFENSE EXPENDITURES AND THE BALANCE-OF-PAYMENTS PROBLEM

One of the problems of great concern to the United States during the last few years has been our unfavorable balance of international payments. The average annual deficit during the period calendar years 1958-60 was \$3.7 billion. In 1960 the deficit was \$3.9 billion. During 1961 and 1962 the deficit was reduced to \$2.4 and \$2.2 billion, respectively, primarily through the use of special borrowing techniques and other special transactions. Without the benefits of these special transactions, the U.S. gross balance-of-payments deficit during this 2-year period would have been approximately \$6.6 billion. The deficit for the first half of calendar year 1963 was estimated at an annual rate of approximately \$4.5 billion. If special transactions are included, the balance for the first half of 1963 is estimated at an annual rate of \$3.2 billion.

In 1957, the United States held over \$22 billion in gold. By the end of 1959, this had declined to about \$19.5 billion. During the period from January 1960 to the present, U.S. gold and foreign exchange holdings were reduced further to about \$15.6 billion. Because of concern over the balance-of-payments problem, President Eisenhower in November 1960 established a program for the Department of Defense which reduced the number of dependents overseas and restricted overseas procurement and purchase of foreign goods for post exchanges. In February 1961, President Kennedy announced further measures for dealing with the balance-of-payments problem. Among other actions, the restriction on dependents overseas was canceled and a Department of Defense program was established to reduce personal expenditures overseas by an amount equivalent to the savings anti-

pated for the previous limitation on the number of dependents overseas.

President Kennedy, in his message to Congress on balance of payments in July 1963, announced a series of additional actions to reduce the U.S. deficit. One of these was a projected reduction in the annual rate of expenditures abroad by the Department of Defense of more than \$300 million below the calendar year 1962 level by measures to be put into effect before the end of calendar year 1964.

The emphasis on this further reduction should not, however, obscure the substantial reduction in net military expenditures abroad which already has been achieved. In July 1962, Secretary McNamara announced as a primary objective a reduction of \$1 billion (from \$2.7 to \$1.7 billion) in the net adverse dollar balance between fiscal year 1961 and fiscal year 1963. This goal has been achieved.

One of the complications in attempting to reduce the balance-of-payments deficit on the "military" account has been the increase in world price levels. During the past few years there has been an average annual price increase in Western Europe of 3 to 4 percent per year. Such price increases may be helpful to the competitive position of the United States, but from the point of view of Defense expenditures, they simply represent rising foreign exchange costs.

The principal ways in which the Department of Defense is attempting to reduce overseas defense expenditures are:

(1) A voluntary savings program by reduction of individual expenditures. Military and civilian personnel and their dependents have been urged to reduce personal expenditures in overseas areas and to channel their family expenditures to U.S. sources, and their savings to U.S. savings bonds, U.S. securities and institutions. It is difficult to measure results in this area but it is estimated that foreign exchange savings of about \$50 million were achieved in fiscal year 1962. The success of this voluntary program is indicated by a 9-percent increase in the number of overseas military personnel purchasing savings bonds through payroll deductions, and 31 percent decrease in parcel post shipments from Army post offices. The latter is evidence of a reduction in purchases of foreign products for shipment.

(2) A program to increase procurement of goods in the United States for use overseas. In general, when it is estimated that the cost of U.S. supplies and services, including transportation and handling costs, will not exceed the cost of foreign supplies and services by more than 50 percent the procurement is made in the United States. During calendar year 1961 and the first 6 months of calendar year 1962, when a 25 percent differential was in effect, we returned approximately \$77.6 million of procurement, which normally would have been made overseas, at an increased cost of approximately \$13.4 million, or an average increase of about 17 percent. During fiscal year 1963, we returned approximately \$75 million of procurements to U.S. sources at an additional cost of approximately \$21 million. Under this program, in the past 2½ years, we have returned approximately \$153 million of procurements, which would normally have been made overseas, at an additional cost of approximately \$34.4 million or about 22.5 percent.

(3) Special reviews of overseas construction programs. By such a review in January 1963 foreign exchange costs in the fiscal year 1963

construction program were reduced by about 50 percent, with a foreign exchange savings of approximately \$97 million over the next 2 to 3 years. The increased budgetary costs will be about \$15 million. This particular reduction will be achieved by eliminating or deferring projects not considered operationally essential and use of revised construction procedures for those necessary projects, as a result of which U.S. labor and material (including prefabs) will be utilized to the greatest extent practicable.

(4) Raising the level of U.S. receipts by encouraging increased procurement of U.S. military equipment by the allies.

(5) Continuing review of employment of foreign nationals at overseas military installations. During fiscal year 1963, the number of foreign nationals employed in overseas areas was reduced.

(6) Reduction of expenditures for contractual services overseas, including expenditures for repairs, alterations, maintenance, etc. A program of directed reductions is now being placed in effect which will assist in stemming the dollar outflow.

(7) Continuing review of dollar expenditures associated with the military assistance program and investigation of ways in which these overseas expenditures may be reduced.

(8) Rotation (without dependents) of certain deployed air units.

During the period 1961-63, defense expenditures abroad were held relatively constant, in spite of increased deployments during the Berlin crisis, a general increase in the defense budget, and increased price and wage levels in certain overseas areas. Moreover, receipts approximately tripled.

The improvement in receipts was achieved in part because of an intensive worldwide sales effort undertaken by the Department of Defense in cooperation with U.S. industry. The Federal Republic of Germany agreed to increase purchases in order to offset U.S. defense dollar outlays, which in West Germany currently amount to about \$700 million per year, the largest single foreign exchange drain. This agreement was extended to cover the period through calendar year 1964. Among other things, the agreement provides for a cooperative logistics system for the armed forces of both countries. The Federal Republic of Germany has agreed to increase its military procurement in the United States and utilize American supply lines, depots, and maintenance and support facilities. Italy similarly has agreed to purchase over \$100 million in military equipment from the United States as the first step toward offsetting foreign exchange costs in that country. Negotiations with other nations along the same lines are continuing.

With respect to defense purchases overseas for use in the United States, the provisions of the Buy American Act and Executive Order 10582 apply. The Buy American Act requires that we buy only from domestic sources end products to be used in the United States, except where the price of such end products is unreasonable or their acquisition would be inconsistent with the public interest. Executive Order 10582 establishes 6 percent, plus duty, as the price differential beyond which the price of domestic products will normally be considered unreasonable. It also provides that the head of an agency may deviate from the general rule on a case-by-case basis when he deems it in the public interest to do so.

The Secretary of Defense has directed that procuring activities buying for use in the United States should continue to evaluate bids in accordance with the provisions of Executive Order 10582. However, when such evaluation indicates that under the prevailing criteria, there should be an award for supplies of foreign origin, the case is first referred to the Secretary for decision. This procedure is continuing, pending the results of a Bureau of the Budget study on Government procurement overseas. During fiscal year 1963, approximately \$8.3 million of procurement normally made overseas was returned to the United States at an additional cost of about \$2.4 million, or approximately 29 percent.

In the case of military assistance, one of the significant advantages is that, while this program helps increase the strength of the free world, it involves relatively small expenditures affecting balance of payments. Within the military assistance program a number of steps have been taken to reduce further the impact on the U.S. balance of payments. Basically, military assistance consists of procurement in the United States of equipment to be delivered to foreign governments. That procurement, which constitutes the bulk of the military assistance program, has no adverse impact on the balance of payments. Therefore, expenditures which enter the balance of payments as a result of military assistance program activities come from only three sources: (1) equipment procured offshore, (2) the NATO infrastructure program, and (3) other expenditures connected with the overseas administration and operation of the program.

NATO infrastructure is a program for the construction of needed military facilities in the NATO area to which all NATO countries (except Iceland) contribute a share of the costs. Facilities constructed by this program are used by U.S. forces assigned in the NATO area as well as by other NATO forces. Successful steps have been taken to reduce the U.S. share of the cost of these facilities. Since the beginning of the infrastructure program the U.S. share has dropped from 48.10 percent to the present 30.85 percent. It is hoped that the U.S. share will be reduced further during the next round of negotiations concerning the cost-sharing formula. In addition, efforts are being made to insure the increased participation of U.S. contractors in bidding for infrastructure contracts.

Including the commitment to infrastructure, expenditures entering the balance of payments resulting from military assistance have been decreasing. If one considers purchases in the United States which may in turn be considered a result of "pump priming" from military assistance, the fiscal years 1963 and 1964 military assistance programs will be net dollar earners.

Two questions related to overseas expenditures are frequently asked: (1) Why is the United States continuing heavy overseas programs in areas where prosperity has reached new heights? (2) To what extent has the United States incurred balance-of-payments costs because our allies have failed to meet commitments?

With respect to the first question, assistance programs in areas such as Western Europe and Japan, which have reached new levels of prosperity, are no longer heavy and constitute a declining percentage in the total military assistance program.

The European program, as a percentage of the total military assistance program, has declined from 38 to 15 percent since 1960. New commitments of grant materiel military assistance to the well-developed nations of Western Europe have been discontinued. The residual programs filling previously made commitments create orders with private manufacturers in the United States which exceed the balance-of-payments cost of fulfilling the U.S. commitments involved. Small training programs and orientation visits have continued in order to promote the continued compatibility of allied weapons and military doctrine and to encourage the purchase of military equipment in the United States. These orientation and training programs conducted with the well-developed nations of Western Europe cost less than 1 percent of the orders received for U.S. produced military equipment from these nations.

As for Japan, where the United States is making no new commitments to provide materiel as grant military assistance, the following statement by Secretary McNamara to the House Subcommittee on Foreign Operations in May 1963 is relevant:

The remarkable economic progress made by Japan has made possible a rapid phaseout of military assistance. As recently as fiscal year 1961, the program for Japan amounted to approximately \$76 million; but we have now shifted entirely to a cost-sharing basis and we are making no new grant aid commitments. At the same time, we are urging Japan to make every effort to strengthen the defenses of Japan which she contributes to the defense of the area. The program for fiscal year 1964 is restricted entirely to fulfillment of prior commitments and these remaining commitments are the cost-sharing projects, mainly in the areas of antisubmarine warfare and air defense.

In Korea, where the United States has an equally vital defense interest, but where resources are more limited, military assistance results in an annual balance-of-payments outflow of just over \$4 million. The main defense dollar outflow in that country is related to the maintenance of U.S. forces under the U.N. command. Total defense expenditures in Korea entering the international balance of payments for fiscal year 1963 amounted to approximately \$95 million.

Further to the south, the Republic of China presents another slightly different case. Her balance-of-payments position and general economic growth are significantly more favorable than Korea's. Defense expenditures in Taiwan entering the balance of payments amounted to slightly less than \$17 million in fiscal year 1963. However, this amount does not appear excessive when measured against the important military and political objectives served by the continuation of the U.S. presence and the aid programs in this critical area.

As to the second question posed above, the balance-of-payments costs at present are only in a small way attributable to the shortfalls of allies in their commitments to NATO planned force goals, and the United States has not, with minor exceptions, oversubscribed its own force goals. Requirements for military force contributions to European defense have been established by the NATO Military Committee. These are coordinated by means of the annual review, and goals are set by common consent.

The United States has subscribed to and met its share of these goals and has urged the European members to meet their goals. Some U.S. combat and other units, excess to U.S. commitments, are stationed in West Germany in direct support of some Federal Republic of

Germany units. Their eventual replacement by Federal Republic of Germany units, however, is anticipated and their balance-of-payments costs are offset in any case through the United States-Federal Republic of Germany offset arrangements referred to above. Deficiencies remaining in allied forces should gradually be rectified through their own efforts.

With respect to deployments in general, technological developments are making possible a higher degree of mobility among all forces. The longer range and greater endurance of weapons systems such as Polaris, the range and capacity of new tactical and transport aircraft, the range, capacity, and staying power of the fleets and amphibious forces all contribute to a greater capacity to project power swiftly and in the required degree.

Advances in tactical and transport aircraft design and in ship design are responsible for much added mobility. The increase in U.S. tactical fighter wings has been matched with increased aerial refueling and ferry range, and greater versatility and firepower of the aircraft themselves. New, long-legged tactical aircraft have the capability of transoceanic deployment on short notice.³

Another facet of expanding the mobility of U.S. based forces lies in the projected quadrupling of the strategic airlift fleet capability from what it was at the beginning of 1961. More than 700 Lockheed C-130 jetprop transports are on hand or on order. These planes have a capability of carrying 92 men, or 36,000 pounds of cargo, over 2,000 miles. It is planned that Lockheed will produce, under an accelerated program based on fiscal year 1964 and prior years' funding, about 66 strategic jet C-141 transports, capable of transporting 127 combat-equipped soldiers, or 63,000 pounds of cargo, more than 4,000 miles. The first prototype C-141 is expected to fly in December 1963.

By pre-positioning of heavy divisional equipment at selected sites abroad, it becomes possible to conserve manpower, yet to deploy more rapidly and to reinforce with combat and service elements those units on the ground or committed by amphibious means. At present, pre-positioned in Europe is the key equipment for 2 full divisions and 10 combat support elements. Such measures will enhance the capacity to respond promptly to threatened aggression.

Greater mobility to the contrary notwithstanding, the American presence in such areas as Western Europe and the Far East must continue for an indefinite period.

³ In addition, the expanded development of foreign designs and the assistance provided under U.S. licensing of large F-104 production programs in Canada, Europe, and Japan make it possible to shift some of the weight and responsibility for local tactical fighters and air defense to our allies.

TABLE IX.—U.S. defense expenditures and receipts entering the international balance of payments

[Millions of dollars]		<i>Fiscal year 1963 (esti- mated)</i>
Expenditures:		
U.S. Forces and their support:		
Expenditures by U.S. military, civilians, and dependents ¹		786.5
Foreign nationals (direct hire and contract hire).....		432.0
Procurement:		
Major equipment.....		76.0
Construction.....		96.5
Materials and supplies.....		556.5
Contractual services.....		503.9
Subtotal.....		2,451.4
Military assistance program:		
Offshore procurement.....		118.4
NATO infrastructure.....		88.4
Other.....		111.1
Subtotal.....		317.9
Total expenditures.....		2,769.3
Receipts.....		
Net adverse balance (DOD).....		1,443.1
Other expenditures (AEC and other agencies included in NATO definition of defense expenditures).....		248.1
Net adverse balance (NATO definition).....		1,691.2

¹ Includes expenditures for goods and services by nonappropriated fund activities.

TABLE X.—U.S. defense expenditures and receipts entering the international balance of payments in Western European NATO and other countries in fiscal year 1963

[In millions of dollars]

	DOD ex- penditures	Other agencies	Defense ex- penditures	Receipts ¹	Net adverse balance
NATO, Western Europe.....	1,510.9	2.5	1,513.4	1,215.8	-297.6
France.....	254.2	.2	254.4	60.3	-194.1
Germany.....	724.0	.6	724.6	1,030.5	+305.9
Italy.....	101.4	.5	101.9	19.3	-82.6
United Kingdom.....	189.4	.3	189.7	18.7	-171.0
Other Western European countries.....	241.9	.9	242.8	87.0	-155.8
Spain.....	47.0		47.0	2.4	-44.6
Canada.....	158.1	146.4	304.5	16.8	-287.7
Japan.....	380.3	1.7	382.0	20.0	-362.0
All other.....	673.0	97.5	770.5	71.2	-699.3
Total.....	2,769.3	248.1	3,017.4	1,326.2	-1,691.2

¹ Receipts data include only: (1) shipments of military materiel and munitions procured and sold through the U.S. Department of Defense; (2) reimbursements to the United States for logistical support of United Nations forces and other nations' defense forces; and (3) sales of services and excess personal property. They do not include estimates of receipts for military equipment procured through private U.S. sources, except where these are covered by government-to-government agreements, e.g., with Germany. Commercial receipts are included in the private sector of the U.S. balance of payments.

PART VIII

CONCLUSION

In the final analysis, the underlying reason for the maintenance by the United States of a large and costly defense establishment including extensive overseas deployments and a substantial military assistance program, is simply this: the most objective assessment that we have been able to bring to bear on this problem leads to the conclusion that the national security self-interest of the United States requires such a program. Our experience in the years leading up to two world wars, and the power of modern weapons, have made it all too clear that a lack of military preparedness, and a failure to participate in and commit ourselves to the defense of vital overseas areas will almost certainly be disastrous to our country.

Our forces are in Europe, the Far East and elsewhere not merely out of a basic common interest in maintaining fundamental freedoms and safeguarding a way of life. They are there out of a sense of need to protect U.S. national interests. In the world of today, when time and distance have been so compressed, it is almost literally the case that any major action anywhere is certain to affect U.S. interests for good or ill. Thus, the security of the United States is threatened when the independence and stability of distant countries are subjected to pressures from the expansionist forces of communism.

The contribution of our forces overseas must be measured not merely in military terms. The political value of the presence of some American forces in Korea, in Berlin, and along the eastern borders of West Germany is equally as important as their purely military value. The physical presence of U.S. forces in critical spots is convincing evidence to our allies of our determination to stand with them in time of crisis. Equally, it warns our enemies, as no other action or series of actions can, that transgression will meet with U.S. resistance. Our own interests, as well as those of our allies, are served by standing together and meeting the threat in forward areas rather than by permitting piecemeal nibbling, which would inevitably result in the collapse of the free world alliance.

In the latter connection, one point of vital significance is sometimes forgotten. Our national politico-military posture is basically designed to deter war. At the same time we must be prepared to meet aggression at all levels should it occur. This is central to our policy.

Even though we do at times become discouraged with what we may regard as inadequate contributions by some of our allies to the common cause, there is simply no way for us prudently to evade the burdens of leadership, and there is no one else ready to assume these burdens. We can and will insist upon an equitable sharing of these. The Department of Defense will continue to pursue efforts in conjunction with other agencies to improve the balance-of-payments impact of defense spending. These efforts have been particularly successful in the European area. We shall continue to seek greater efficiency in our own organizations and operations, and we shall continue to exhort our allies to increase their efforts along these lines. But the facts of life appear to leave no alternative to the prospect that the United States must continue to carry the responsibility of free world leadership for a long time to come.

PART IV
BUSINESS CYCLE INFLUENCES IN THE U.S.
BALANCE OF PAYMENTS

**A. B. HERSEY, Adviser, Division of International Finance,
Board of Governors of the Federal Reserve System**

BUSINESS CYCLE INFLUENCES IN THE U.S. BALANCE OF PAYMENTS

A. B. HERSEY, ADVISER, DIVISION OF INTERNATIONAL FINANCE,
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

No evaluation of developments in the U.S. balance of payments can give a fair picture of underlying trends without taking account of cyclical elements. The cyclical elements that are most readily recognizable are of two kinds: (1) Fluctuations of U.S. imports around their longer term trend, reflecting mainly the U.S. business cycle; and (2) fluctuations of U.S. exports around their longer term trend, reflecting mainly business cycles in industrial countries abroad. Fluctuations of capital movements can sometimes also be explained, at least in part, as due to cyclical factors here or abroad, but the cyclical influences on capital movements are more complex and are less easily summarizable in general terms, than those on imports or exports. This will be evident in a comparison of shifts in capital movements during two recent periods of U.S. cyclical expansion, given in a later part of this paper.

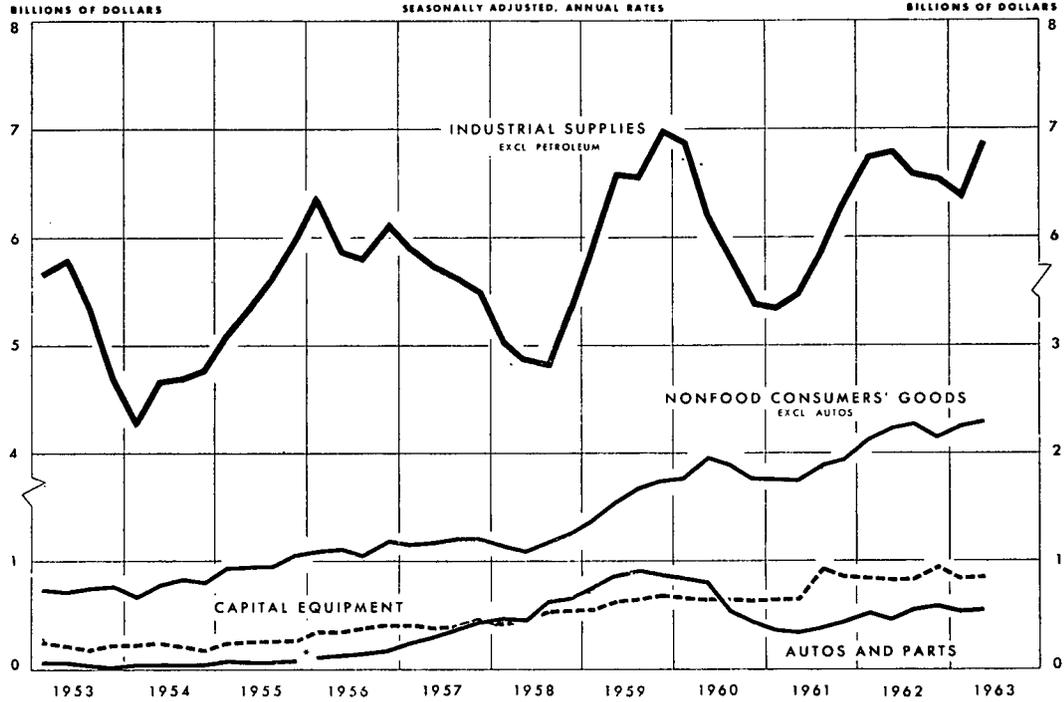
1. CYCLICAL ELEMENTS IN THE BEHAVIOR OF U.S. IMPORTS

It is clear from the accompanying charts 1 and 2, which show various components of U.S. imports grouped according to end uses, that by far the largest cyclical swings occur in imports of industrial supplies. Imports of nonfood consumers' goods and of capital equipment are also affected by U.S. business cycles, but to a much smaller extent—if autos and parts are excluded. In recent recessions imports of these two kinds have dropped temporarily below their long-term trends, but without much absolute decline (except in imports of autos and parts in 1960-61). The big swing in auto imports to a peak in 1959-60 and then to a trough in early 1961 coincided more or less with the U.S. business cycle, but the size of this swing must be regarded as exceptional, reflecting as it did the first large-scale incursion of foreign competition in the U.S. auto market and the subsequent counterattack by the U.S. industry with compact cars.

Imports of foods and beverages, of petroleum (chiefly crude oil and residual fuel oil), and of miscellaneous items—the three series shown in chart 2—exhibit little if any cyclical behavior. Fluctuations in foods and beverages are to be explained in terms of special factors such as price changes for coffee, sugar, and cocoa, and shifts in supply-demand relationships for meat and livestock. The sharp drop in petroleum imports in the second quarter of 1959 reflected the introduction of quotas on crude oil imports.

After the 1957-58 recession, U.S. imports rose sharply from mid-1958 to the spring of 1959. After the 1960-61 recession, they rose sharply at mid-1961, and continued to increase moderately until the autumn of 1962. The magnitudes of the increases in these periods of expansion are indicated in table 1, which shows values in the half-

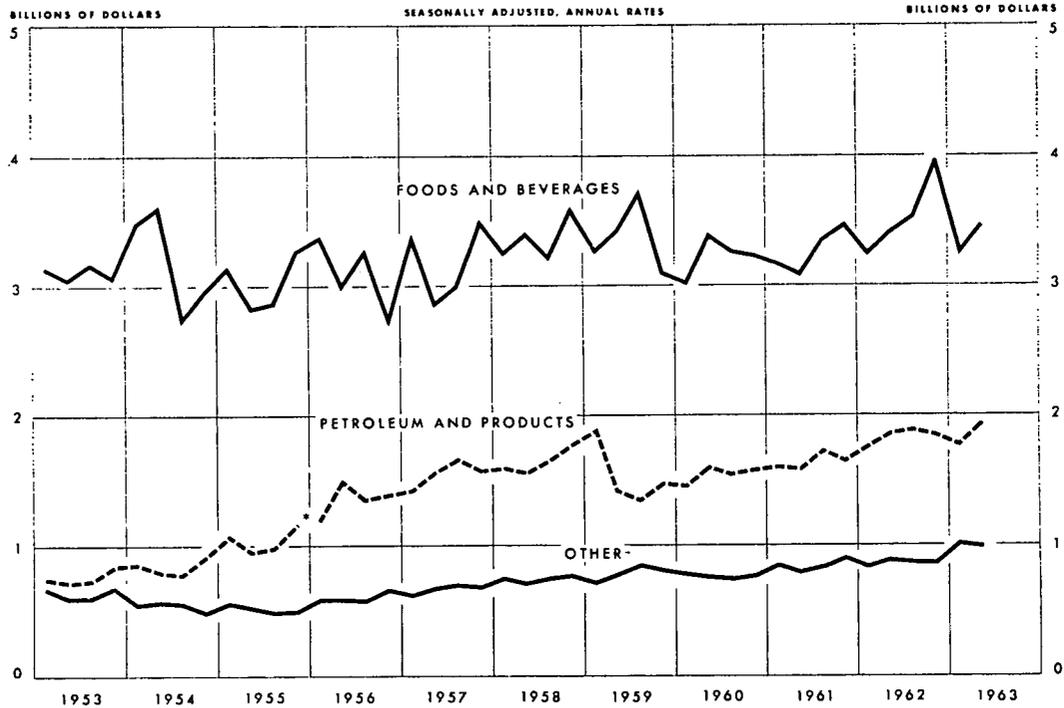
CHART 1
 UNITED STATES IMPORTS BY END-USE CATEGORIES



* 1953-1955 DATA UNADJUSTED

SOURCE: DEPARTMENT OF COMMERCE DATA SEASONALLY ADJUSTED BY FEDERAL RESERVE.

CHART 2
 UNITED STATES IMPORTS BY END-USE CATEGORIES



* 1953-1955 DATA UNADJUSTED

SOURCE: DEPARTMENT OF COMMERCE DATA SEASONALLY ADJUSTED BY FEDERAL RESERVE.

years in which imports were cyclically lowest¹ (first half of 1958 and first half of 1961) and in the following full calendar years (1959 and 1962) when domestic activity and imports were at higher levels. The rise in 1958-59 was by \$2.7 billion or 21 percent (based on seasonally adjusted annual rates), and the rise in 1961-62 was by \$2.5 billion or 18 percent.

It is of some interest to compare these import increases with the simultaneous increases in industrial production. The industrial production increase in each cycle was somewhat smaller than the corresponding import increase: in 1958-59, 17 percent and in 1961-62, 11 percent.²

Each of these increases in imports and in industrial production during a period of cyclical recovery and advance may be usefully split up into purely cyclical and other components. It may be estimated roughly, to begin with, that trend increases of about 5½ percent per annum for imports and 4 percent per annum for industrial production contributed about 7 percentage points and 5 percentage points, respectively, to the observed increases during the time intervals we are dealing with.³

In addition, the import increases included components not related either to long-term trends or to purely cyclical demand factors—e.g., the sharp rise in value of food imports in 1961-62, the decline in petroleum imports in 1959 when quotas were imposed, and also some part of the 1958-59 rises in imports of automobiles and of steel.

TABLE 1.—U.S. imports classified by end uses

[In billions of dollars, seasonally adjusted at annual rates]

	1st half 1958	Year 1959	1st half 1961	Year 1962
Industrial supplies and materials, excluding petroleum and products.....	4.94	6.48	5.50	6.64
Petroleum and products.....	1.56	1.52	1.62	1.82
Food and beverages.....	3.31	3.37	3.18	3.52
Nonfood consumer goods, excluding autos and parts.....	1.10	1.57	1.78	2.19
Automobiles and parts.....	.47	.85	.34	.52
Capital equipment.....	.44	.62	.65	.85
Other.....	.72	.78	.84	.86
Total.....	12.54	15.19	13.91	16.40

Source: For 1958-59, Department of Commerce, Office of Business Economics, "Balance of Payments Statistical Supplement, Revised Edition." For 1961-63, Department of Commerce, Bureau of the Census, quarterly tabulations IQ-271-OBE. Seasonal adjustment by Federal Reserve Board.

Rough estimates taking account of these special factors and of the trend component suggest that the cyclical component of import increase was somewhere between 12 and 15 percentage points in the first of these two cycles, and about 10 percentage points in the second. For industrial production, the cyclical components were perhaps 12 percentage points and 6 percentage points, respectively.

¹ The domestic business cycle troughs of these 2 cycles, as measured by the industrial production index, occurred respectively in April 1958, and in the 4 months December 1960-March 1961. Allowing for a lag of about 2 months in changes in import arrivals after changes in industrial production, an appropriate 6-month period to represent the import trough in the 1st of these cycles would be the 2d and 3d quarters of 1958, rather than the 1st half-year. However, there was very little change in the level of total imports from the 1st to the 3d quarter, and convenience dictates the use of the calendar half-year.

² Measured from 1st half of 1958 to year 1959 and from 1st half of 1961 to year 1962. A more refined calculation would use slightly earlier periods in order to allow for the lag referred to in preceding footnote. The results of the calculation and subsequent analysis would not be improved significantly, considering the degree of uncertainty attached to other elements in the subsequent analysis.

³ These intervals are of 15 months, taken from the center of a low half-year to the center of the following high year.

All estimates of this sort, attempting to distinguish between the effects of trend, cycle, and special factors, are necessarily somewhat arbitrary. First, it is difficult to establish meaningful trend rates of growth over short periods of time. Second, it is difficult to distinguish sharply between cyclical changes in imports and those ascribable to special factors. Two examples of the second of these difficulties are given by the 1958-59 experience. First, some part of the rise in automobile imports at that time, but not all of it, may be classified as special rather than cyclical, for reasons indicated earlier. Second, the \$1.5 billion rise in the annual rate of imports of industrial supplies excluding petroleum from the first half of 1958 to the year 1959 included, besides a small trend component and an important cyclical element for materials other than steel, a rise of \$0.4 billion in imports of steelmill products the classification of which as cyclical or as special is almost impossible to settle, especially in the absence of any good data on domestic steel consumption and inventories. Clearly, some part of the wave of steel imports in late 1958, 1959, and early 1960 contributed to the net buildup of domestic steel inventories that certainly occurred over that period, and to this extent should be regarded as cyclical. But some part took the place of domestic steel output lost during the steel strike of 1959 and not fully made up for by high production before and after the strike; this element of the import wave should be regarded as special. The difficulty of splitting 1959 steel imports into these two categories is the reason for estimating the 1958-59 cyclical element of import increase in terms of a wide range (12 to 15 percentage points).

This analysis, imperfect as it is, leads to a tentative conclusion that in the last two business cycle periods of recovery and advance the purely cyclical elements of increase in total imports were somewhat more than proportionate to the cyclical elements of increase in industrial production. When attention is directed to imports of industrial supplies excluding petroleum (chart 1), where the bulk of the cyclical rise in imports is to be found, it is immediately obvious that in this sector the cyclical element of import increase, in each of the last two cycles, was much more than proportionate to the cyclical element of increase in industrial production, being of the order of magnitude of 20 to 25 percent in the 1958-59 period and again something like 20 percent in the 1961-62 period.

The explanation of this pattern of behavior lies undoubtedly in the behavior of inventories during U.S. business cycles, coupled with the fact that imports of materials provide a quick way of supplementing domestic production of materials, and so of maintaining supply-demand equilibrium, at times when demand rises rapidly either for materials that will go to raise inventories or for materials being consumed more rapidly, the domestic output of which cannot be economically expanded quickly enough.

Inventory behavior, both in the cycle of U.S. industrial production and in the cycle of imports, involves not only upswings but also downswings. Each phase of the cycle conditions the subsequent one. The observed upswings in flows of production and imports in the past two cycles reflect not only the typically more-than-normal inventory buildup during the later part of a recovery phase, but also the fact that around the trough of the cycle inventories were being run down.

The greater the previous downswing, the more likely it was to have carried production or imports on down below sustainable trend levels of flow. Then in the subsequent recovery period production and imports have to rise enough to regain their trend levels and to bring to a halt the rundown of inventories, and then enough more to reestablish an equilibrium level of inventories, even if no fresh buildup of inventories to above-normal levels occurs.

These observations on the conditioning of an upswing by the downswing that preceded it may have an important application in understanding developments in 1963. Much of the 1961-62 upswing in domestic production and imports served to bring flows up to equilibrium levels, without involving large inventory accumulation. This is reflected in the fact that the change in total nonfarm business inventories during 1962, as measured in the GNP accounts, was only 0.9 percent of 1962 GNP, whereas in 1959 the corresponding ratio was over 1.3 percent and in 1955 about 1.4 percent. This favorable comparison results in turn partly from the fact that in 1962 U.S. industrial production leveled out in the second half of the year, while final sales continued to rise. Tendencies toward overexpansion of inventories that had been beginning to develop in the first half of 1962 were halted early enough to avoid the ripening of a cyclical position that might have led later to a full recession.

Thus the situation in the latter part of 1962 and early 1963 was that the earlier upswing was not continuing, but no recession was developing. Inventory buildup was in general not far from long-term normal needs. U.S. imports were relatively level (see charts 1 and 2), with continuing uptrends in several categories of imports, and with some nonsignificant though rather marked fluctuations in imports of foods. A new upswing in production and imports from such a position might differ markedly from the upswings of 1958-59 and 1961-62, and might conform much more closely with balanced rates of growth than those upswings did, and might include much less of a purely cyclical component.

If we turn away from the consideration of purely cyclical elements of change in imports to the broader matter of the total change in imports during a period in which cyclical recovery and advance is superimposed on longer term growth, the question of longer term growth rates assumes importance. In the changes from first half of 1958 to year 1959 and from first half of 1961 to year 1962 (table 1), the trend element of increase in imports appears to have been close to \$1 billion in each instance (at a rate of say \$750 million per annum, or about 5½ percent per annum).

In percentage terms the trend increases for imports of industrial materials (table 1 and chart 1) were quite moderate, and were perhaps even smaller than the 4 percent per annum trend rate of increase we have postulated for industrial production during those periods. In value terms, these trend increases were of the order of \$200 million in each of the two periods of upswing.

Other categories of imports rose in total by a little more than \$1 billion in the 1958-59 advance, and by about \$1½ billion in 1961-62. These other categories are less cyclically sensitive than the imports of materials, but some of them do tend to rise more rapidly during a period of general expansion in the domestic economy than at other times, so that a (minor) part of these total increases may be

considered purely cyclical. As previously noted, special factors have also been important for some of these categories, and the fact that the total increase was greater in 1961-62 than in 1958-59 was due wholly to the greater rise in value of food imports. Finally, over a full cycle some of these other categories have shown very steep rates of growth. Nonfood consumer goods other than autos and parts, for example, rose by 39 percent in value from the year 1959 to the year 1962. The average annual rate of cumulative growth over this period was 11½ percent, only slightly less than the rate of growth from 1953 to 1959, which was 13½ percent. In dollar amounts this group alone contributed about \$500 million to the 1958-59 increase in imports, and of this perhaps nearly \$200 million reflected the underlying trend.

There is little doubt that many types of imports have become attractive to domestic consumers and users of capital equipment. But the maintenance of stability of prices and costs in the United States should help to slow down the rapid trend rates of growth which some of these imports have had in the past decade.

2. EXPORTS IN RELATION TO FOREIGN AND U.S. BUSINESS CYCLES

Export changes can be analyzed in a manner parallel to that employed above for imports—attempting to distinguish between trend factors, cyclical factors, and special factors. The cyclical factors chiefly relevant for such an analysis of U.S. exports, however, are not U.S. domestic business cycle developments, but those abroad, primarily in the other major industrial countries.

Limitations of time prevent the inclusion of an analysis of this sort in this paper. One example of recent work on this subject is the article by Mr. Masson and Mr. Boddie of the Office of Business Economics, Department of Commerce, on "Factors Affecting U.S. Merchandise Exports," in the Survey of Current Business, February 1963.

An understanding of why the U.S. balance of payments changed in the ways it did during each of the last two phases of U.S. cyclical recovery and advance requires, as a first step, at least some brief consideration of the changes in exports in each of these periods. Table 2 shows the level of exports in each starting period when U.S. imports were low and in the following year of higher imports. For each period, imports are shown in the second line of the table, and the trade surplus in the third.

TABLE 2.—U.S. trade surplus

[In billions of dollars, seasonally adjusted annual rates]

	1st half 1958	Year 1959	1st half 1961	Year 1962
Exports.....	16.3	16.3	19.6	20.5
Imports.....	12.6	15.3	13.6	16.1
Trade surplus.....	3.7	1.0	6.0	4.3

NOTE.—Data are as adjusted in balance-of-payments statistics. Discrepancies in subtraction reflect rounding.

The striking fact brought out by this table is that while imports advanced by about \$2½ billion in each of the two recent U.S. recovery

phases, the trade balance deteriorated much more in 1958-59 (by \$2.7 billion) than it did in 1961-62 (\$1.7 billion). This was because U.S. exports were virtually unchanged in the year 1959 from what they had been in the first half of 1958, whereas in 1962 they were almost \$1 billion larger than they had been in the first half of 1961. (The table also shows that in the interval between 1959 and the first half of 1961 U.S. exports advanced sharply while U.S. imports were declining, producing a sharp rise in the U.S. export surplus during the last stage of the rising phase of the U.S. cycle and the subsequent recession of 1960-61.)

In 1958-59, other industrial countries were in a phase of stable total demand, with clear signs of recession in certain industries such as steel and textiles until recovery began early in 1959. European business cycles were clearly out of phase with the U.S. cycle, with lags behind the U.S. cycle averaging about three-quarters of a year at the point of upturn. For this reason U.S. exports reached a low point in the early months of 1959. The subsequent recovery led finally to much higher U.S. exports in 1960, but the total for the year 1959, as already noted, was no higher than the rate in the first half of 1958.

In the next U.S. recovery phase, from the first half of 1961 to the year 1962, U.S. exports were rising, though not as rapidly as in the interval from 1959 to 1960.

British import demand was more or less level in 1961-62, after a great bulge in British import buying in 1960. Japanese import demand, too, was diminishing temporarily after its very rapid expansion between mid-1959 and mid-1961. In these two countries the business cycle was sharply out of phase with the U.S. cycle, with downturns setting in in 1961 not very long after recovery started here. On the European Continent, however, the long period of expansion of industrial activity that began in 1959 continued throughout 1961 and until the latter part of 1962. These developments, together with the Canadian cyclical recovery in 1961-62, and also a rise in outflow of U.S. private and Government capital to countries other than those of Western Europe, Japan, and Canada, help to explain why U.S. exports continued to rise from early 1961 into 1962, though only moderately, and why much of this rise was concentrated in exports to the less industrialized countries.

Besides the foreign cyclical factors briefly touched on in the preceding paragraphs, another factor affecting U.S. exports in 1958-59 and 1961-62 deserves mention. This is the changing international competitive position. Unquestionably, over a period of several years up to 1959 the competitive position of the United States was weakening, relative to the European countries and Japan. This was the way relative costs and prices were moving at the time of the severe drop in U.S. exports from 1957 to 1958, and it was still the way they were moving during the 1958-59 cyclical recovery.

In contrast, since 1959 relative changes in money wage levels and domestic price levels here and abroad have been in a direction favorable for the U.S. position. However, productivity gains are being achieved in foreign countries as well as in the United States, and particularly in their exporting industries. Unfortunately there is no good statistical basis for judging what the net effects have been on costs for export-competing and import-competing goods here and

abroad. Statistics on productivity gains are too broad in their coverage, and statistics on export prices (or unit values) are in many cases very imperfect and even when reliable they do not provide evidence about the profitability of production and the incentives to push export sales efforts.

Finally, it is difficult to establish from the trade statistics themselves that the United States has yet regained much of the ground that had been lost by the worsening of relative cost levels up to 1959. This difficulty arises partly from the difficulty of establishing clearly what part of U.S. export changes should be ascribed to cyclical and special factors. Attempts at measuring cyclical changes are often simplified by assuming that the long-term trend is a straight line. But this simply begs the question, and takes the analysis round in a circle. The key question, to which no satisfactory answer is yet available, is whether the long-term trend line of U.S. exports has or has not begun in recent years to tilt upward a little more than it was doing in the 1950's when the competitive position of the United States was clearly worsening.

3. CAPITAL MOVEMENTS, THE TRADE BALANCE, AND PRESSURE ON U.S. GOLD RESERVES

It has been found in past years that when domestic business activity rises, the cyclical shrinkage in the trade surplus is sometimes accompanied by a shrinkage in the net outflow of private capital for short-term or long-term investment. Experience in the two latest U.S. cyclical recovery phases is shown in table 3. In each case, comparisons are made between annual rates of trade and capital flow balances in the first half of a calendar year (1958 and 1961, respectively), when imports were cyclically depressed, and the corresponding balances in the subsequent full year (1959-62) when domestic activity and imports had reached higher levels.

The 1958-59 expansion phase gives an excellent example of offsetting changes in trade and capital balances. The shrinkage of the trade balance, by \$2.7 billion, between the first half of 1958 (annual rate) and the year 1959 was counterbalanced to the extent of \$1.8 billion by a decline in net outflow of private capital other than foreign private liquid funds. If the increased inflow of foreign private liquid funds is also counted, the shrinkage of the trade balance was fully offset.

But in the next cyclical recovery and expansion period, 1961-62 the results were quite different. The trade balance declined by \$1.7 billion, but there was no decline at all in the balance of long-term and short-term private capital excluding movements of foreign private liquid funds. And foreign private liquid funds, which had been flowing in during the first half of 1961, showed no net movement over the full year 1962. The result of these changes in trade and private capital movements combined was to put a much greater potential pressure on U.S. gold reserves in 1962 than in the first half of 1961. This pressure was met, however, by special Government transactions which held down the accumulation of foreign official reserves that might have been converted to gold.

TABLE 3.—Selected elements of the U.S. balance of payments

[In billions of dollars]

	Half-year of depressed imports (Seasonally adjusted annual rates)	Year of higher imports	Change
1st half of 1958 and full year 1959:			
Trade balance-----	3.7	1.0	-2.7
Private capital flow balances:			
Long term-----			
Short term, excluding foreign liquid funds-----	-2.7	-1.6	+1.1
Foreign private liquid funds ¹ -----	-.6	.1	+.7
Foreign private liquid funds ¹ -----	.4	1.3	+.9
Errors and unrecorded transactions-----	.5	.4	-.1
Gold loss, International Monetary Fund position, rise in foreign countries' official liquid assets in United States, and special Government receipts ² -----	2.3	2.9	+.6
1st half of 1961 and full year 1962:			
Trade balance-----	6.0	4.3	-1.7
Private capital flow balances:			
Long term-----			
Short term, excluding foreign liquid funds-----	-1.6	-2.5	-.9
Foreign private liquid funds ¹ -----	-1.5	-.6	+.9
Foreign private liquid funds ¹ -----	.8	.0	-.8
Errors and unrecorded transactions-----	-1.2	-1.0	+.2
Gold loss, International Monetary Fund position, rise in foreign countries' official liquid assets in United States, and special Government receipts ² -----	.7	3.4	+2.7

¹ Change in U.S. short-term liabilities to, and increase in holdings of U.S. Government bonds and notes by, foreign private holders including commercial banks (excluding international institutions and foreign governments and central banks).

² Including debt prepayment receipts, advances on U.S. military exports, and sales of nonmarketable medium-term securities.

Why was the experience in 1961-62 so different from that in 1958-59?

One important difference between the two periods was in the behavior of interest rates. Interest rates in this country, after dropping very sharply in the 1957-58 recession, rose very rapidly from mid-1958 to the end of 1959, when they reached their postwar highs. New foreign and international bond issues in the United States were exceptionally large in the first half of 1958, and then were of only average volume in 1959. Also, there was a moderate outflow of U.S. bank loans in the first half of 1958, and then virtually none in 1959 (when there was a small net increase in foreign commercial credits to the United States).

In 1961-62, the experience was very different. Interest rates in the United States, after falling somewhat in the first part of 1960, were unusually stable throughout the recession of 1960-61 and the recovery of 1961-62, with only a moderate rise in U.S. short-term money market rates from late 1961 on through 1962. New foreign bond issues in the United States tended to grow in this period, rather than shrink as they had done in 1958-59. However, contrary to what might have been expected with bank credit in general freely available in this country, there was a sharp drop in the outflow of U.S. bank credit to Japan and other countries that had been borrowing rather heavily from U.S. banks during 1960 and 1961.

Evidently, the contrasts in the behavior of new foreign issues and of U.S. bank credit outflow in these two periods were due only in part to the timing and extent of the changes in availability and cost of credit in this country.

Further effects of interest rates may be seen in movements of liquid funds other than U.S. bank credit. In neither of the periods being considered were the movements of U.S. corporation funds into short-term foreign currency assets particularly large or changing much; the principal outflow of this kind in recent years occurred in the second half of 1960, after wide spreads had opened up for a while between short-term money market rates abroad and those in this country. But there was a sharp contrast between the two periods 1958-59 and 1961-62 in the behavior of foreign private holdings of liquid assets in the United States. In 1959, when some foreign countries were encouraging their commercial banks to enlarge their holdings of liquid dollar assets, there was a sharp inflow into foreign private short-term investments in the United States. In contrast, between the first half of 1961 and the year 1962 such inflows diminished sharply, partly in consequence of a rising tendency of interest rates in European centers on dollar deposits and loans in the so-called Euro-dollar market.

Finally, contrasts between the two periods in the movements of equity capital, included in table 3 in the figures for long-term capital, were also important. The outflow of U.S. direct investments abroad did not vary much. But foreign purchases of U.S. common stocks were stimulated in 1959, when U.S. imports were high, by the sharp rise in the U.S. stock market which at that time was still reflecting persistent expectations of longrun inflation in the United States. In 1961-62, however, strength in the U.S. stock market in anticipation of economic recovery and expansion brought in relatively heavy foreign purchases in the first half of 1961 when U.S. imports were low. In 1962, foreign purchases of U.S. common stocks were much smaller.

The complexity of factors influencing private capital movements out of or into the United States indicates that we cannot count on having automatic offsets in the capital account of the balance of payments to each and every rise in U.S. imports or decline in the U.S. trade surplus. What will happen in a particular period depends on the particular circumstances at the starting point and thereafter. Three features of the flows in the fourth quarter of 1962 and first quarter of 1963 are now of particular interest.

First, new foreign security issues in the United States (net of foreign participations) were at a very high annual rate of nearly \$2 billion in these two recent quarters, mainly as a result of unusually large Canadian borrowings. This rate of outflow was about three times as large as the average annual outflow in 1957-61.

Second, foreign purchases of U.S. common stocks, and also foreign direct investments in the United States, were at a very low level in the two recent quarters, together less than \$0.1 billion at an annual rate. This compares with an annual average inflow during 1959-61 of over \$0.4 billion, and heavier rates of inflow during some shorter periods of time.

Third, net outflows of U.S. short-term and medium-term bank credit were very low in this 6-month period, only about \$0.2 billion at an annual rate. This compares with an outflow of more than \$1 billion in 1961.

PART V
WILL GROWTH END THE PAYMENTS DEFICIT:
THE LESSONS OF PAST EXPERIENCE

By
JACK C. ROTHWELL, Economist, Federal Reserve
Bank of Philadelphia

WILL GROWTH END THE PAYMENTS DEFICIT: THE LESSONS OF PAST EXPERIENCE

JACK C. ROTHWELL, ECONOMIST, FEDERAL RESERVE BANK OF PHILADELPHIA¹

During 12 of the past 13 years the United States has sustained a deficit in its international balance of payments. The deficits have amounted to a total of \$26 billion. To finance this sum we have transferred \$8 billion in gold to foreigners and have increased our liquid liabilities by \$18 billion.

The policies undertaken to relieve the deficit have ranged all the way from Government-sponsored programs to expand exports to a decrease in the dollar value of duty-free goods that American tourists may bring in from abroad. Yet still the deficit has continued.

In recent months a relatively new balance-of-payments hypothesis has gained widespread acceptance: that the deficit can be relieved through an acceleration in the rate of economic growth in this Nation. In this paper we examine the degree of confidence which might be accorded this hypothesis on the basis of past experience with growth and the balance of payments.

REASONING BEHIND THE GROWTH HYPOTHESIS

The rationale behind the growth proposition concerns both the international capital and trade transactions between this country and foreign nations. It is reasoned, first of all, that more rapid economic growth in the United States will make this Nation more attractive to foreign and domestic investors, more attractive because accelerating growth will create a greater demand for capital and a rise in profits and interest rates. Greater demand for capital and higher profits and interest rates will cause both domestic and foreign investors to channel more of their funds into U.S. investments—into new plant and equipment, purchases of stocks and bonds, and into short-term investments, such as Treasury bills. The increased investment at home, it is reasoned, will mean a reduction of investment funds flowing abroad, funds that reached a \$3.3 billion total last year.

It is also reasoned that accelerating economic growth would have favorable effects on our trade position. A higher growth rate, the argument goes, would increase income and demand for goods. Greater demand for goods would increase production from present levels, thereby doing two things: (a) Cutting unit costs of production and (b) providing more profits so business could modernize plant and equipment, thus further cutting costs. This double-edged decrease in costs would help both our export industries and our import-threatened industries to compete with foreign goods.

It is recognized that the rise in incomes created by a hike in the growth rate will mean an increase in imports and thus an increased outflow of dollars for imported goods. But the growth proposition

¹ The views expressed here are solely those of the author. They do not necessarily reflect the thinking of officials within the Federal Reserve Bank of Philadelphia.

concludes that the combination of (a) the decrease in capital flowing abroad and (b) the better competitive position of our export and import industries will provide more than enough counterforce to make up the increased imports and still contribute to a reduction in our deficit.

This is the argument. Let us examine it in the light of past experience.

TECHNIQUE OF ANALYSIS

Since the theory hinges on growth one might go back in history, look at periods characterized by substantially differing rates of economic growth, and see how our balance of payments actually behaved. During periods of fastest growth, for example, did the rate of capital outflow really decline in response to greater demands for capital and higher profits and interest rates? And what actually happened to the trade balance?

To answer these questions, balance-of-payments flows first were examined during different phases of the business cycle. Every cycle since 1920 was analyzed to see if discernible patterns of behavior could be established for balance-of-payments items as the cycle phase shifted from fast growth to slow growth to recession. Then longer timespans were examined to see if the expected growth patterns emerged. First, then, how did the balance of payments behave over the differing growth phases of the business cycle? The answer to this question is provided in the tables which follow. But before we examine the findings, let us first take a look at the structure of the tables.

TABLE I.—Percent of total business cycles during which item contributed to an improvement in the balance of payments ¹

Balance-of-payments item	1920-62 (10 expansions, 10 recessions)		1945-62 (5 expansions, 5 recessions)	
	Expansions	Recessions	Expansions	Recessions
1. Net private capital flows abroad.....	2 20	2 80	4 20	4 80
(a) Direct investments.....	3 33	3 67	4 20	4 80
(b) Long-term portfolio investments.....	3 37	3 63	40	60
(c) Short-term investments.....	3 44	3 56	4 20	4 80
Net private capital flows abroad plus ½ errors and omissions.....	50	50	40	60
2. Foreign direct and long-term portfolio investment in the United States.....	70	30	80	4 20
3. U.S. private capital flows less foreign direct and long-term investment.....	50	50	40	60
Above plus ½ errors and omissions.....	40	60	40	60
4. Exports of goods and services (excluding military transactions).....	60	40	60	40
5. Imports of goods and services.....	30	70	4 20	4 80
6. Net export balance.....	50	50	60	40
7. Net export balance less difference in U.S. capital outflows and foreign capital inflows. Above including total of errors and omissions.....	50	50	60	40
	60	40	60	40

¹ In this and following tables balance-of-payments items from which the ratios are derived are expressed in average monthly flows of funds. An improvement during the boom phase (say in capital account) would occur if the rate of outflow of funds decreased relative to that in the preceding recession period or if an outflow of funds in the recession were replaced by an inflow. NBER reference dates were used to determine cycle periods and quarterly balance-of-payments data (yearly data in the earlier period) were interpolated to arrive at the average monthly flows of funds for each cycle.

² Statistically significant at 90 percent level.

³ Odd number because of fewer cycles, 9 for direct investment and short-term capital, 8 for long-term portfolio investment.

⁴ Statistically significant at 80-percent level.

TABLE II.—*Percent of total business cycles during which item contributed to an improvement in the balance of payments*

[6 months' lag in balance-of-payments items]

Balance-of-payments item	1920-62 (10 expansions, 10 recessions)		1945-62 (5 expansions, 5 recessions)	
	Expansions	Recessions	Expansions	Recessions
1. Net private capital flows abroad.....	30	70	² 20	³ 80
(a) Direct investments.....	30	70	² 20	³ 80
(b) Long-term portfolio investments.....	¹ 50	50	40	60
(c) Short-term investments.....	¹ 56	44	60	40
Net private capital flows abroad plus ½ errors and omissions.....	50	50	40	60
2. Foreign direct and long-term portfolio invest- ment in the United States.....	60	40	60	40
3. U.S. private capital flows less foreign direct and long-term investment.....	60	40	60	40
Above plus ½ errors and omissions.....	50	50	60	40
4. Exports of goods and services (excluding military transactions).....	² 80	² 20	³ 100	³ 0
5. Imports of goods and services.....	² 10	² 90	0	100
6. Net export balance.....	40	60	40	³ 60
7. Net export balance less difference in U.S. capital outflows and foreign capital inflows. Above including total of errors and omissions.....	60	40	60	40
	50	50	40	60

¹ Odd number because includes only 9 cycles; long-term investment item computed for 8 cycles.² Statistically significant at 90-percent level.³ Statistically significant at 80-percent level.TABLE III.—*Percent of total business cycles during which item contributed to an improvement in the balance of payments*

Balance-of-payments item	1945-62 (5 recessions, 5 expansions)	
	Fast growth phase	Stability
1. Net private capital flows abroad.....	¹ 80	¹ 20
(a) Direct investments.....	60	40
(b) Long-term portfolio investments.....	¹ 80	¹ 20
(c) Short-term investments.....	60	40
Net private capital flows abroad plus ½ errors and omissions.....	60	40
2. Foreign direct and long-term portfolio investment in the United States.....	40	60
3. U.S. private capital flows less foreign direct and long-term investment.....	¹ 80	¹ 20
Above plus ½ errors and omissions.....	60	40
4. Exports of goods and services (excluding military transactions).....	¹ 0	¹ 100
5. Imports of goods and services.....	¹ 100	¹ 0
6. Net export balance.....	¹ 0	¹ 100
7. Net export balance less difference in U.S. capital outflows and foreign capital inflows.....	40	60
Above including total of errors and omissions.....	¹ 20	¹ 80

¹ Statistically significant at the 80-percent level.

TABLE IV.—Average annual percent change in selected balance-of-payments flows over periods associated with differential rates of economic growth ¹

[Minus signs indicate a deterioration in the balance of payments]

Balance-of-payments items	1921-29	1930-39	1948-56	1959-62
1. Net private capital flows abroad.....	-8.6	+11.8	-24.7	-6.1
(a) Direct investments.....		+11.6	-12.6	-1.0
(b) Long-term portfolio investments.....		-6.0	-59.7	-8.3
(c) Short-term investments.....		-4.4	-137.2	-14.6
Net private capital plus ½ errors and omissions.....	-11.5	+14.1	-86.3	-4.3
2. U.S. private capital outflows plus ½ errors and omissions less foreign direct and long-term portfolio capital inflows.....	-4.0	+7.4	-53.5	-15.1
3. Net export balance.....	-2.4	+5.8	-6.6	+54.4
4. Net export balance less combined U.S. and foreign capital flows.....	-5.4	+7.8	-9.6	+130.9
5. Above including 100 percent of errors and omissions.....	-9.2	+7.1	-9.4	+70.2

¹ Percent change over the period is calculated from an average for the first 2 years of the period to an average of the last 2. Simple annual rates of growth as measured by the industrial production index are as follows: 1921-29, 11.6 percent; 1930-39, 2.3 percent; 1948-56, 6.0 percent; 1959-62, 4.0 percent.

THE TABLES

Column 1 of the first three tables contains several balance-of-payments items, both individual entries and selected groupings. First, for example, we have the total of net private capital flows abroad and then the subitems which compose these capital flows.

Next, we have foreign direct and long-term portfolio capital flows into this country. Third is the difference between private capital outflows and foreign capital flowing in, both including and excluding a portion of errors and omissions.

Next comes exports of goods and services, imports, and our net export balance. Finally, we have combined our net capital flows, trade balance, and errors and omissions.

The remaining columns contain a series of ratios for each balance-of-payments item and group. The ratios tell us the percentage of business cycles in which an improvement occurred as we changed from a slower to a faster rate of growth. For example, if in 8 of the 10 cycles occurring since 1920 the capital flow slowed down as we moved from recession to expansion, then we would put an 80 percent in the expansion column and 20 percent in the recession column, indicating that capital flows contributed to an improvement in our balance of payments 80 percent of the time as we entered the faster growth phase.

The cycles in the first two tables are broken into two time periods: the period 1920-62 and the subperiod 1945-62. Granted, our balance-of-payments data were not so good during the earlier years, but the similarity of behavior during the two periods is an indication that the data may be adequate for the type of analysis employed.

Now to the findings of the analysis. What actually happened to our balance-of-payments items as we moved from slower to faster rates of growth?

RESULTS

1. Looking first at the net private capital flow abroad in table I, we see a different sort of picture than we might have anticipated, given the growth hypothesis. In only 2 out of the 10 cycles compos-

ing the 1920-62 period (and also in only 20 percent of the postwar cycles) was our balance of payments better off in the fast growth or expansion phase than it was in the recession phase.

2. Looking next at the items composing our net private capital flow abroad, we see that all (including short-term capital flows) contributed to an improvement more often in recessions than in the accompanying expansion phase. The pattern is even more pronounced in the postwar cycles than in the period as a whole.

3. When we add one-half of errors and omissions to the net private capital flow abroad we see a 50-50 pattern during the entire period 1920-62, indicating no preponderance of improvement in expansions or recessions. In the postwar period, however, there is still a slight edge in favor of improvements during recessions.

4. When we calculate the difference between U.S. capital outflows and foreign capital inflows we once more see a 50-50 pattern during the 1920-62 period and a slight edge in favor of improvement during recessions for the postwar period.

Adding one-half of errors and omissions to the U.S. capital flow changes the pattern only slightly. In both periods we are better off 6 out of 10 recessions and 4 out of 10 booms.

5. Looking next at the trade picture, we see that exports tend to improve our balance-of-payments position most often during the expansion phase. This is true for both periods. Imports, however, help improve our balance-of-payments position only rarely during expansions. Calculating our net export balance, we see a 50-50 pattern during the entire period, indicating no preponderance of improvements in expansions or recessions. In the postwar period a slight edge appears during the expansion phase.

6. The last entry in table I combines our capital flows, net export balance, and errors and omissions. As can be seen, this most comprehensive measure of our balance-of-payments performance gives a slight edge to improvements during the expansion phase. This is true both for the 1920-62 period and the 1945-62 period.

Yet the margin is small. During 6 out of 10 cycles this combination of items shows improvement as we move from slow to fast growth; during 4 out of 10 cycles it shows deterioration. Indeed, the test for statistical significance (the footnotes on the table show which items may be considered statistically significant), this test tells us that we can have virtually no confidence that the 60-40 pattern did not evolve simply due to chance.¹

In summary, then, private U.S. capital tends most often to cause deterioration rather than improvement as we move from recession to expansion. But when corrected for errors and omissions and for foreign capital inflows, the total capital account shows little preponderance for improvement during either the expansion or recession phase. Similarly, our net export balance shows no marked tendency toward improvement in either expansions or recessions. The same thing is true when we group capital, the net export balance, and errors

¹ The Chi-square test was used to determine statistical significance. The hypothesis formulated was that the items contributed predominantly to neither improvement nor deterioration in our balance of payments during either phase of the cycle. A rejection of this hypothesis on the basis of the test indicated that an item did indeed contribute predominantly to improvement or deterioration. The percentage indicates the degree of confidence (i.e., 80 percent, 90 percent) with which the hypothesis was rejected. This confidence did not prove extremely high even for the items where the hypothesis was rejected.

and omissions. One would thus be hard pressed to make a case for the growth hypothesis on the basis of table I.

But let us go a step further. It is quite possible that the balance of payments responds to an increase in the rate of growth only after a time lag. One might reason, for example, (a) it takes time for increased growth to be reflected in rising profits and interest rates, (b) it takes time for investors to become aware of the increased growth, higher interest rates, and profits in this country and (c) time is required for the physical arrangements necessary to direct a larger volume of investment into the domestic economy.

Table II shows the recession-expansion comparison adjusted to include a 6-month lag in the payments items. Yet despite the lag adjustment, the main groups of items show a striking similarity to those in table I.

The total U.S. private capital outflow tends to cause deterioration in the balance of payments as we move from recession to expansion but, after correcting for errors and omissions and also when coupled with foreign capital inflows, the combined capital account once more shows little preponderance for improvement during either the expansion or recession phase.²

Similarly, though both exports and imports show a higher concentration of improvements in the expansion and recession phases, respectively, the net export balance exhibits no significant preponderance of improvements in either phase. The same pattern holds true when we group together the combined capital, the net export balance, and errors and omissions. Thus on the basis of table II one would also be hard pressed to make a case for the growth hypothesis.

Yet it is still possible that a very fast rate of cyclical growth might result in a balance-of-payments pattern more in keeping with the growth hypothesis. To test this possibility, a comparison was made of the behavior of the post-World War II balance-of-payments items within the expansion phase: as the cycle moved from the trough into the very fast upward phase and then leveled off into the phase of relative stability or "bumping along the top" as it is sometimes called. What, then, happened as the cycle moved from fast growth to stability? In fact, an interesting change occurred.

As shown in table III, we have a concentration of improvements in capital flows during the fast-growth phase. Both (a) U.S. private net capital and (b) the combined U.S. outflow and foreign inflow accounts show improvement in 80 percent of the cycles during the fast-growth phase. When we include errors and omissions, however, both accounts drop down to a statistically insignificant level: growth-phase improvements during only 60 percent of the cycles.

The net export balance in every cycle shows deterioration in the fast-growth phase and improvement in the stability phase.

Finally, when we combine capital, the export balance, and errors and omissions, we have improvement during the fast-growth phase during only one out of five cycles. The predominance of capital account improvements during the upswing erodes under the pressure of the export balance and errors and omissions.

² It should be noted, however, that short-term capital flows now show a predominance of improvements as the cycle moves from recession to expansion (the postwar period).

Thus even though the growth hypothesis looks a little better on capital account in the fast-growth/stability comparison, by no means are we able to establish the proposition.

But so much for the cycle. Let us now look at the balance-of-payments items over longer time periods.

GROWTH AND THE BALANCE OF PAYMENTS OVER LONGER PERIODS OF TIME

Table IV shows average annual percentage changes in selected balance-of-payments items during two fast-growth periods, 1921-29 and 1948-56 and two relatively slow-growth periods, 1930-39 and 1959-62. Granted, the depression period is associated with rather extraordinary events affecting the world economy, but since the years for which we have balance-of-payments data are limited, the period is included with the obvious caveat.

In general, table IV suggests that fast-growth periods are associated with deterioration in the balance of payments (increases in outflows of funds or decreases in inflows), and slow-growth periods with improvement. The table should not be taken, however, as evidence that the reverse of the growth hypothesis is true. The observations are too few, data in the earlier period are not without question—to mention just two reservations. Rather one might say that the table is not calculated to inspire confidence in the validity of the growth hypothesis.

As for the individual items in table IV, percentage increases in private capital flowing abroad are greater during the fast-growth periods (though this tendency is less evident when U.S. capital outflows are coupled with foreign capital inflows). The net export balance deteriorates during the fast-growth periods and improves during the slow-growth years, as does the grouping of capital, net export balance, and errors and omissions.

CONCLUSIONS

One might be tempted to draw the conclusion from this analysis that there is a slight edge in favor of the proposition that a faster rate of growth tends to promote disequilibrium in the balance of payments; that imports tend to grow faster than exports during the fast-growth periods, and that businessmen tend to invest more at home—but also more abroad during expansions (e.g., “Profits look good so let’s expand in Cincinnati, and while we’re at it we might reconsider the subsidiary in Milan” or “things look good the world over so let’s stretch out for an extra 1 percent on a Canadian issue”).

Yet such a conclusion is probably unwarranted. After all (and as previously mentioned) the balance-of-payments observations are relatively few; the results of all comparisons were not uniform in outcome; the data may be questioned; there is some secular trend in the cyclical comparisons (though from an examination of the data this problem is considered to be minimal).

To be on firmer ground one might conclude instead that the evidence presented suggests that the growth hypothesis may be a case of oversimplification, that the behavior of our balance of payments is an extremely complex multivariate function which defies simple explana-

tion, that there is simply no clear-cut tendency for an acceleration in the rate of growth to bring about an improvement in our balance of payments.

Given this conclusion, then, what guidance might this study offer the policymaker? Perhaps the following.

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An increase in the rate of economic growth may help relieve our balance-of-payments deficit. Then again, it may not. Hence the wisdom which may be gained from this study is perhaps this: we should not count too heavily on growth as an equilibrating force; we should not put all our eggs in this basket; we should not even commit half our eggs. Instead, we should continue to strive for balance-of-payments equilibrium across the entire broad spectrum of public and private policy. And perhaps we should intensify our efforts.

APPENDIX

—
QUANTITATIVE RESTRICTIONS MAINTAINED ON
IMPORTS BY CERTAIN FOREIGN COUNTRIES

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By the
Bureau of Economic Affairs, Department of State

QUANTITATIVE RESTRICTIONS MAINTAINED ON IMPORTS BY CERTAIN FOREIGN COUNTRIES

BUREAU OF ECONOMIC AFFAIRS, DEPARTMENT OF STATE

This review of quantitative restrictions on imports covers the members of the International Monetary Fund that have accepted in full their obligations to maintain convertible currencies in the sense of article VIII of the Fund agreement. As provided in article VIII these countries may not introduce exchange restrictions on imports or on other current payments without the approval of the Fund. Most of these countries are also contracting parties to the General Agreement on Tariffs and Trade (GATT). All of them have given up their resort to the provisions of the GATT that permit a contracting party to maintain quantitative restrictions on imports to protect its balance of payments.

Sixteen countries have accepted the obligations of article VIII of the Fund agreement and are contracting parties to the GATT, as follows: Austria, Belgium, Canada, Cuba, Dominican Republic, France, Germany, Haiti, Italy, Kuwait, Luxembourg, Netherlands, Peru, Sweden, United Kingdom, and United States.

Eight countries have accepted the obligations of article VIII of the Fund agreement but are not contracting parties to the GATT, as follows: El Salvador, Guatemala, Honduras, Iceland, Jamaica, Mexico, Panama, and Saudi Arabia.

The attached lists of commodities cover, in the main, quantitative import restrictions that take the form of specific quotas or prohibitions; they do not ordinarily cover commodities whose importation may be subject to licensing on a case-by-case basis.

It should be noted that there are a number of reasons specified in the GATT and unrelated to the balance of payments that would justify the maintenance of restrictions on imports; specifically essential national security interest, health, safety and sanitary regulations, protection of public morals, and to secure compliance with laws or regulations which are not inconsistent with the provisions of the GATT, and so forth.

By and large the restrictions in the attached lists maintained by contracting parties to the GATT were originally justified on balance-of-payments grounds. However, they have been retained for other reasons, some of which may not be consistent with the provisions of the GATT, after balance-of-payments considerations were no longer relevant.

Saudi Arabia, Jamaica, the Dominican Republic, Honduras, and Haiti do not impose quantitative restrictions on imports, per se, but use licensing systems. Saudi Arabia has no general criteria established for the issuance of import licenses; Jamaica and the Dominican Republic use import licensing systems for certain items under national trade laws; and Haiti uses import licenses on a case-by-case basis. Honduras applies both a consular and a customs surtax on all imports, with certain exceptions for imports from the Central American Common Market countries. Peru and Kuwait do not maintain quantitative restrictions on imports. Peru uses surcharges in lieu of quantita-

tive restrictions. Kuwait has a very liberal commercial policy and import controls are applied to only a few items.

The attached lists do not cover restrictions maintained by the United States or by Cuba; they cover the other 22 countries that have accepted the article VIII of the Fund agreement. Japan is also included; although it has given up its recourse to the provisions of the GATT that permit the use of restrictions for balance-of-payments purposes, it has not yet accepted the full obligations of article VIII of the Fund agreement.

The following list represents an attempt to give a complete and up-to-date list of quantitative restrictions maintained by the countries mentioned in the preceding paragraphs. Because of frequent changes in liberalization and deliberalization, however, we cannot guarantee complete accuracy.

Quantitative restrictions on imports

<i>Tariff No.</i>	AUSTRIA
01.01 A-----	Live horses, for slaughter.
01.02-----	Live bovine cattle including buffalo, for slaughter.
01.03-----	Live pigs, for slaughter.
02.01-----	Meat and edible offals of the animals falling within headings No. 01.01, 01.02, 01.03, or 01.04, fresh chilled or frozen.
02.02-----	Killed poultry of No. 01.05 meat and edible offals (except liver), fresh, chilled, or frozen: Fowls, ducks and geese, turkeys.
02.05-----	Unrendered pig fat free of lean meat and unrendered poultry fat, fresh, chilled, frozen, salted, dried, or smoked.
02.06-----	Meat and edible offals (except poultry liver), salted, dried, or smoked.
04.01-----	Milk, and cream, fresh, not concentrated or sweetened.
04.02-----	Milk and cream, preserved, concentrated, or sweetened: Dry (milk powder), other.
04.03-----	Butter.
06.01-----	Bulbs, tubers, corms, crowns and rhizomes of flowering or foliage plants.
06.02 B-----	Phanerogamous plants whether in flowering status or not.
06.02 C-----	Trees and shrubs except silvicultural plants (see 06.02 E).
06.02 D-----	Vines.
06.02 E-----	Silvicultural plants.
06.03 A-----	Cut flowers and flower buds for bouquets or for ornamental purposes, fresh.
06.04 A-----	Foliage, branches and other parts of trees, shrubs, bushes, grass, moss, fresh, etc. other than: Christmas trees.
07.01-----	Vegetables, fresh or chilled: <ul style="list-style-type: none"> Potatoes. Tomatoes. Cabbages: Cauliflower, brussels sprouts, turnips, white cabbage, other. Spinach, sorrel, chicory, and other salad vegetables: spinach, lettuce, other. Green beans and peas. Cucumbers and pumpkins of all kinds: Cucumbers, pumpkins, except aubergines and zucchini, green (fresh) pepper. Asparagus. Carrots, parsnips, radishes, and other edible roots: carrots, celery, radishes, red beets, other edible roots. Rhubarb, white celery. Onions. Edible mushrooms. Other, except capers.

Quantitative restrictions on imports—Continued

AUSTRIA—Continued

<i>Tariff No.</i>	
08.04.....	Grapes, fresh, also pulp.
08.06.....	Apples, pears.
08.07.....	Apricots, peaches, cherries, mahaleb cherries, plums, other stone fruit except medlar and sloes.
08.08 A.....	Strawberries.
08.08 C.....	Currant.
10.01.....	Wheat and mixed wheat and rye.
10.02.....	Rye.
10.03.....	Barley.
10.04.....	Oats.
10.05.....	Maize (corn).
10.07.....	Millet and durra.
11.01.....	Cereal flours.
11.02.....	Cereal groats and cereal meal, other worked cereal grains (rolled or flakes, etc., except husked, glazed, and broken rice), edible germs of cereals.
11.03.....	Flowers of the leguminous vegetables falling within heading 07.05.
11.06.....	Flour and meal of manioc.
11.07 A.....	Malt, unroasted.
11.08.....	Starches and starch flour, inulin.
11.09.....	Gluten (roasted or not) and gluten flour.
12.01.....	Poppyseed and ripe poppy pods.
12.02.....	Soybean flour and mustard meal, not deoiled.
12.03.....	Seeds and fruit of a kind used for sowing.
13.03 C.....	Pectin, except citrus pectin.
15.01.....	Lard, lard oil, and rendered poultry fat.
15.02.....	Raw and rendered tallow of cattle, sheep, and goats other than technical tallow such as prime tallow, fancy tallow, and yellow grease.
15.03.....	Lard stearine, oleostearine, lard oil, oleomargarine not emulsified or mixed or prepared in any way.
15.07 B.....	Pumpkin seed oil.
15.07 C-2.....	Purified soybean and cottonseed oil, peanut oil, coconut oil, palm oil, palm kernel oil.
15.13.....	Margarine, mixtures of edible fats (artificial edible fat) and other prepared edible fats other than mixtures of hardened oils.
16.01.....	Sausages and the like of meat or meat offals.
16.02.....	Other prepared or preserved meat and meat offals except pate de foie gras.
16.03.....	Meat extracts, soups, and broths.
17.01.....	White sugar.
17.02.....	Other sugars, sirup, artificial honey, caramel, except: maple, palm, birch, and millet sugar, as well as sugar extracted from soybeans, chemically not pure.
17.03.....	Molasses, whether or not decolorized.
17.05 B.....	Flavored or colored sugars and sirups (not including fruit juices containing added sugar) except vanilla-flavored sugar.
19.02.....	Preparations of flour, starch, or malt extract, of a kind used as infant food or for dietetic or culinary purposes not containing cocoa.
19.03.....	Macaroni, spaghetti, and similar products.
19.07.....	Bread, ship's biscuits, and other ordinary bakers' wares, not containing sugar, honey, eggs, fat, cheese, or fruit.
19.08.....	Pastry, biscuits, cakes and other fine bakers' wares not containing cocoa.
20.01 B-1.....	Other mushrooms (than truffles), onions and cucumbers, preserved by vinegar or acetic acid, with or without salt, spices, mustard, or sugar added, in airtight containers of 15 kilograms gross weight or less; except cocktail onions.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	AUSTRIA—Continued
20.01 B-2-----	Other mushrooms (than truffles), onions, cucumbers, preserved by vinegar or acetic acid, with or without salt, packed in airtight containers of more than 15 kilograms as well as other mushrooms (than truffles), onions and cucumbers, preserved by vinegar or acetic acid, with spices, mustard, or sugar added.
20.01 C-1-----	Vegetables preserved by vinegar or acetic acid, with or without salt, spices, mustard, or sugar added, packed in airtight containers of 15 kilograms gross weight or less.
20.01 C-2-----	Vegetables preserved by vinegar or acetic acid, with or without salt, packed in airtight containers of more than 15 kilograms as well as vegetables preserved by vinegar or acetic acid, with sugar, spices, or mustard added.
20.02 A-----	Vegetables preserved otherwise than by vinegar or acetic acid, packed in airtight containers of 15 kilograms gross weight or less except truffles, olives, and capers.
20.02-----	Tomatoes, sauerkraut, and other vegetables (except truffles, olives, and capers) preserved otherwise than by vinegar or acetic acid, in other than airtight containers of 15 kilograms of gross weight or less.
20.07 A-----	Thick juices of apples, pears, grapes, and vegetables, whether or not containing sugar, but unfermented and not containing alcohol.
20.07 B-----	Juices of apples, pears, grapes, and tomatoes, whether or not containing sugar, but unfermented and not containing alcohol.
21.07-----	Food preparations not elsewhere specified or included: With a basis of milk and eggs. Others (than extracts or other basis and saccharine).
22.01-----	Mineral water.
22.04-----	Grape must, fermentation or with fermentation arrested otherwise than by addition of alcohol.
22.05-----	Wine of fresh grapes, including grape must with added alcohol.
22.06-----	Vermouths and other wines flavored with aromatic essences.
22.07-----	Other fermented beverages such as cider, berry, and mead.
23.02-----	Bran.
23.05 A-1-----	Wine lees, liquid.
23.07-----	Animal food preparations other than of meat wastes.
24.02-----	Manufactured tobacco; tobacco extracts and essences.
25.15-----	Sawn slabs of marble stone of less than 16 cm. thickness.
27.02 A-----	Lignite, except pitch coal.
27.10 H-----	White oils (Vaseline oil, paraffin oil).
27.10 I-----	Transformer oil.
28.17 A-----	Caustic soda, except sodium hydroxide in aquatic solution.
28.35 A-----	Sodium sulfide.
28.37 A-1-----	Potassium and sodium sulfites, bisulfites, and metasulfites except sodium bisulfite.
28.38 A-1-----	Aluminum sulfate.
28.38 A-2-----	Copper sulfate.
28.40 B-1-----	Sodium orthophosphates.
B-2-----	Sodium pyrophosphates, sodium polyphosphates, and sodium metaphosphates.
28.40 B-3-----	Potassium phosphates.
28.42 A-6a-----	Sodium carbonate, calcined.
28.54-----	Hydrogen peroxide.
29.02 A-----	Methyl chloride, ethyl chloride, trichloroethane, tetrachloroethane, trichloroethylene, tetrachloroethylene, hexachlorobutadiene, hexachlorobenzene, monochloronaphthalene.
29.02 C-----	Dichloro-diphenyl-trichloroethane (DDT).
29.14 B-1-----	Acetic acid.

Quantitative restrictions on imports—Continued

		AUSTRIA—Continued
<i>Tariff No.</i>		
29.36 A	-----	Para-aminobenzene sulfactamide, phthalylaminobenzenesulfacetamide sulfanilamido Xaminoszobenzene; their salts.
29.44 A	-----	Penicillin, tyrothricin.
30.03 A	-----	Penicillin.
30.03 B	-----	Medicinal preparations, including veterinary preparations, containing antibiotics.
30.04	-----	Band-aids of all types and forms.
32.07 E	-----	Pigments on zinc sulfide basis (i.e. lithopones).
32.07 L	-----	Ultramarine.
32.09 A	-----	Stamping foil of pigments or metal powder.
32.09 B	-----	Lacquer, paints, water colors, etc., except pearl essence.
32.10	-----	Artists' and students' colors, in tablets, tubes, pans, and similar forms, including such colors in boxes with or without brushes, palettes, or other accessories.
32.13 A	-----	Printing inks.
32.13 B	-----	Writing and other inks (except printing, stamp pad, and china inks).
33.06	-----	Toilet preparations other than shaving creams; "Franzbranntwein" (alcoholic liniment); paper tissues scented and/or medicated; smelling bags made of paper.
35.06	-----	Glues, pastes, and similar adhesives of all kinds, not elsewhere listed, made up for retail sale in containers of 1 kilogram and less, except rubber solutions for use in connection with nonvulcanized rubber.
36.02	-----	Prepared explosives.
36.06	-----	Matches.
37.03 B	-----	Sensitized paper, paperboard and cloth, unexposed or exposed but not developed except color paper and color paperboard.
37.06	-----	Cinematographic film of photoelectrically recorded sound track (no pictures), exposed and developed (negative and positive).
37.07	-----	Other cinematographic film, exposed and developed (whether or not incorporating a sound track, negative and positive) except such for toy projectors.
38.0	-----	Activated bentonite.
38.07	-----	Spirit of turpentine.
38.08	-----	Colophony.
38.19 K	-----	Peroxide in solid form.
38.19 N	-----	Chemical products and byproducts not elsewhere specified or included, except: Ammonium persulfate with fillers; benzoylsuperoxide with fillers; bonderizing agents; potassium bromide with fillers; chloride kresochlorocynrol mixture; iron mordants; bituminized iron powder; fireproofing paints, ramming mixes, fusel oil, crude; hart's horn oil, crude; potassium bromate with fillers; synthetic sodium aluminum silicate (containing water); naphthol stabilizer; polyethyleneglycoles, liquid; quartzsand-slag mixture; salts and esters of industrial fatty acids; suppository bases; clay-peaty earth; Zero-Mist; complex fillers and extruders on chalk basis; coatings for ingot molds; quartz-basalt mixtures for the production of floor and road covering material; mixtures of ammonium persulfate and fillers; mixtures of potassium bromate, mixed gases used for automotive purposes.
39.01	-----	Synthetic resin laminated fabrics.
39.02	-----	Emulsions and dispersions of polyvinyl acetate.
39.03	-----	Methyl cellulose and carboxymethyl cellulose, including hydrous solutions of same.

Quantitative restrictions on imports—Continued

AUSTRIA—Continued

<i>Tariff No.</i>	
39.07.....	Products of plastic materials of No. 39.01 through No. 39.06 except products of resin laminated hard paper and vulcanized fiber (other than spools, cones of any type and boxes), viscose sponges, tear-open strips of glassine paper, hand lamps without battery or bulbs.
40.06.....	Self-adhesive tape.
40.13.....	Taylor's supplies of rubber, except dress preservers.
40.14.....	Other rubber goods and other articles except: articles made of gutta-percha, balata, patent plates; soft rubber torches without electric fittings, vibration dampers ("Silentblock" "Schwingmetall"), friction wheels or discs, rubber rubbing parts on spinning equipment ("Nitschelhosen") and rubber printing cloth.
42.01.....	Saddlery and harness for all kinds of animals of any material.
42.02.....	Travel goods such as trunks, suitcases, hatboxes, traveling bags, haversacks, knapsacks, kitbags, handbags, wallets, purses, satchels, briefcases, collar boxes, dressing cases, pouches, etc., except such made of wood with leather covering; telescope sheaths for walking-stick umbrellas and etuis of cardboard and metal covered with other material.
42.03 A-1.....	Leather gloves for the protection of workers.
42.03 B and C.....	Wearing apparel and accessories of leather and artificial leather.
42.04 A.....	Driving belts of leather.
42.04 B.....	Other leather articles for industrial use except gasmeter membranes and blanes.
42.05.....	Other articles of leather or artificial leather.
44.22.....	Casks, barrels, vats, tubs, buckets, and other cooperage and parts thereof, of wood, other than staves falling within heading 44.08.
45.04.....	Cork disks for bottle lids.
46.03.....	Articles of basket or wickerwork made directly to shape from plaiting materials or articles made from goods falling within heading No. 46.01 or 46.02; articles made of loofah.
48.07 A.....	Art paper and chromopaper, not for production of sensitive papers.
48.07 C.....	Gummed paper, other than transfer picture paper, in rolls or sheets, except self-adhesive gummed paper with protective paper cover.
48.15.....	Gummed paper, cut to size and shape except self-adhesive gummed paper with protective paper cover.
48.16.....	Bags and other packing containers of paper or paperboard.
48.18.....	File binders.
49.09.....	Picture postcards, Christmas cards, and other picture greeting cards, printed by any process, with or without trimmings; except Christmas cards with pictures of any type.
49.11.....	Picture postcards and greeting cards in sheets, printed by any process, also cut to size.
54.03.....	Flax yarn not put up for retail sale.
54.04.....	Flax or ramie yarn put up for retail sale.
54.05.....	Woven fabrics of flax or of ramie.
56.05 B.....	Yarn of rayon staple fiber or rayon staple fiber waste, not put up for retail sale.
56.07 A, B-2.....	Woven fabrics of rayon staple fiber except rayon staple fiber fabrics blended with textiles of ch. 51.53 at a rate of more than 8 percent (of weight) or blended with synthetics of ch. 56.
57.05.....	Hemp yarn.
57.06.....	Jute yarn.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	AUSTRIA—Continued
57.07 B, C-----	Yarn of vegetable fibers similar to jute and the like (except) coir yarn.
57.09-----	Woven fabrics of hemp.
57.10-----	Woven fabrics of jute.
58.01-----	Machine-braided rugs.
58.02-----	Carpets, carpeting, rugs, mats, and matting, made up or not, of cotton or rayon staple fiber.
58.04 A-1-----	Raised pile furniture fabrics of cotton.
58.04 A-2-----	Corduroys of cotton.
58.04 B-1-----	Raised pile furniture fabrics of silk or manmade fiber blended with rayon staple fiber.
59.04-----	Twine, cordage, ropes, and cables of textile fibers except manmade fiber other than rayon staple fiber and manmade fibers blended with rayon staple fiber.
59.09 B, C-----	Textile fabric coated or impregnated with oil, cut into ribbonlike strips.
60.02-----	Knitted, netted, or crocheted gloves and mittens, not rubber elastic or rubberized of other than silk, waste silk, and continuous manmade fibers of natural polymers, and cotton.
60.03-----	Knitted, netted, or crocheted stockings, understockings, socks, and the like, not rubber elastic or rubberized, of other than silk or waste silk, continuous manmade fibers of natural polymers, and cotton.
61.01-----	Men's and boys' outer garments.
61.02-----	Women's, girls', and infants' outer garments.
61.03-----	Men's and boys' shirts and parts thereof, of cotton.
61.06-----	Shawls, scarves, mufflers, mantillas, veils, and the like of any fiber, fully made up; these articles cut to size but not fully made up, of rayon staple fiber, cotton blended with rayon staple fiber and linen.
61.07-----	Ties, bow ties, and cravats.
62.01-----	Blankets and traveling rugs.
62.02-----	Household goods (bed linen and bedspreads, table linen, toilet linen, kitchen linen), curtains and other furnishing fabrics made to size but not finished, of flax and ramie, rayon staple fiber or fibers blended with rayon staple fiber; all aforementioned goods of any textile fiber, if fully made up.
62.03-----	Bags and silks for packaging purposes made of jute.
62.04-----	Tarpaulins, tents, awnings, sunblinds, and similar made-up goods; sails and camping goods.
64.01-----	Footwear with outer soles and uppers of rubber or plastics material.
64.02-----	Footwear with outer soles of leather, composition leather, rubber or plastic materials, other than footwear falling under heading 64.01.
64.03-----	Footwear of wood; footwear with wooden or cork soles except wooden sandals.
64.04-----	Footwear with outer soles of other materials, such as cordage, paperboards, textile fabrics, felt, plaiting, etc.
65.01-----	Hat bags and hoods (including discs and cylinders) of felt, neither blocked to shape nor with made brims.
65.03-----	Felt hats and other felt headgear, made from felt hoods falling within heading 65.01, trimmed or not.
65.04-----	Lined and trimmed hats and other headgear, plaited or made from plaited or other strips of any material; also women's and girls' hats and headgear of this kind, unfinished.
65.05 A-----	Hairnets other than plaited hairnets.
65.05 B-2-----	Hats and other headgear made from pieces of woven or knitted fabrics (other than strips), lace, or other material.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	AUSTRIA—Continued
65.06 B.....	Other hats and headgear except helmets other than of plastic materials or fitted with earphones.
66.02.....	Walking sticks (including Alpine sticks and seat sticks), canes, whips, riding crops, and the like, other than metal sticks.
67.01.....	Articles made of feathers or down.
67.02 A.....	Artificial flowers, foliage, or fruit.
67.02 B.....	Parts of artificial flowers, foliage, or fruit, except such made of textiles.
67.02 C.....	Articles made of artificial flowers, foliage, and fruit.
67.04.....	Wigs, false beards, hair pads, curls, switches, and the like, of human or animal hair or of textiles; other articles of human hair (including hairnets).
68.02.....	Worked monumental or building stone, or articles thereof, other than goods falling within position No. 68.01 and chapter No. 69, and other than mosaic cubes and stones, and fancy or decorative articles weighing 5 kilos and less.
68.13.....	Mixtures on the basis of asbestos or asbestos-magnesium carbonate and articles made thereof except asbestos fibers, powder mixtures of asbestos and other materials, asbestos paper, board, felt, and yarn.
68.14.....	Friction material of a kind suitable for brakes, for clutches or the like, with a basis of asbestos or other mineral substances, or of cellulose, whether or not combined with textile or other materials, in the form of segments, discs, washers, strips, sheets, plates, rolls, etc.
69.08.....	Glazed ceramic construction material other than glazed paving and flags; glazed wall tiles of china.
69.13.....	Wired lamps and lighting fixtures with protective glass, for ceilings, walls, corners, and mirrors, as well as their wired sockets.
70.09.....	Glass mirrors, unframed, framed or backed, except rear-view mirrors and spherically shaped mirrors for traffic purposes.
70.10.....	Carboys, bottles, flacons, jars, pots, tubular containers and similar containers, of glass, used for the packing or transport of goods; stoppers and other closures of glass, except demijohns of a capacity of 3 or more liters, covered up to the spout, and miniature demijohns.
70.13.....	Domestic and stationary glassware, other than articles falling within heading No. 70.19, except such articles in combination with other materials.
70.14.....	Glassware for illuminating and signaling as well as optical purposes (but not made of optical glass), except such articles in combination with ornamented or nickel-plated nonprecious metals, with nickel or aluminum, with gilded or silver-plated nonprecious metals.
70.20.....	Glass wool and articles made thereof.
71.07 C-E.....	Semifinished gold and gold alloys, such as rods, wires, etc.; gold foil, gold spangles.
71.12 A.....	Jewelry of silver and plated silver.
71.12 B.....	Parts of gold jewelry.
71.12 C.....	Jewelry of platinum and platinum metals.
71.13 A.....	Silversmiths' wares of silver and plated silver.
71.13 B.....	Parts of goldsmiths' wares of gold.
71.13 C.....	Goldsmiths' wares of platinum and platinum metals.
71.14.....	Other precious metal or precious metal plated articles other than such of platinum and platinum metals, and articles plated with platinum and platinum metals.
72.01.....	Coins.
73.23.....	Casks, drums, cans, boxes, and other similar containers of sheet or plate iron or steel as used for the conveyance or packing of goods, except such with a capacity of 10 liters or more.

*Quantitative restrictions on imports—Continued***AUSTRIA—Continued**

<i>Tariff No.</i>	
73. 25-----	Stranded wire, cables, cordage, ropes, plaited bands, slings and the like, of iron or steel wire, other than insulated cables for electrical purposes.
73. 27-----	Woven wire (including wire mesh and wire cloth) and welded wire grill, of iron and steel.
73. 36-----	Nonelectric types of space heaters, ranges, including types for central heating, ovens for kitchen ranges, cookers, plate warmers and related kitchen utensils, parts of malleable cast iron for items of this number (cauldrons and parts for all items other than of malleable cast iron are liberalized).
82. 01-----	Spades, shovels, picks, hoes, forks, rakes, scrapers, cultivators, axes, hatchets, chopping knives, and similar cutting hand tools.
82. 02 A-4-----	Circular saw blades.
82. 02 A-5-----	Saw mill frame saw blades.
82. 02 B-2-----	Metals saws and metal saw blades other than for metal band saws and segment circular.
82. 03 A-----	Pliers except pipe wrenches, bolt clippers, heavy blacksmith tongs, embossing pliers, ignition coil pliers with copper ends.
82. 03 C-----	Wrenches and related tools except tension wrenches and dutch tongs and unworked blanks.
82. 03 D-----	Plies and rasps.
82. 04 B-----	Woodworking tools except veneer cutting and planing machines, bevel cutting machines, bevel irons.
82. 04 F-----	Hand vices except screw clamps.
82. 09-----	Table and kitchen knives, other knives, except hair thinning knives, and silver- or gold-plated knives of alpaca.
82. 14 A-----	Spoons of other than stainless steel; forks of iron and steel.
82. 14 B-----	Other table and kitchenware of nonstainless steel.
84.06 D-----	Pistons, piston rings, and piston pins except blanks.
84.10 E-----	Injection pumps and parts therefor, for internal combustion engines.
84.29-----	Roller mills for flour mills.
84.44 B-----	Rolls for rolling mills, of nonmalleable iron, weighing 25,000 kilograms or less each.
84.45-----	Single-spindle drilling machines up to 50 millimeters.
84.57-----	Rolls for glass mill machinery, of nonmalleable cast iron, weighing 25,000 kilograms or less each.
84.61-----	Mountings and fittings of copper alloys such as brass, etc., for water, heat, and sanitary installations.
85.01 A-----	Three-phase motors weighing less than 100 kilograms.
85.02-----	Electromagnetic (solenoid) clutches.
85.04-----	Electrical storage batteries (excluding such for pit and hand lamps); plates for storage batteries of plastic materials and other materials.
85.11 A-----	Electric soldering irons and electric welding apparatus and machines for plastic materials with an import value of less than A£200,000 per unit.
85.12 A-----	Hotplates.
85.12 C-----	Other electrical supplies and appliances except electrical baking hoods, heaters for curling irons, continuous-flow water heaters, electric boilers, space heaters with a permanent capacity of 3 kilowatts, espresso machines, deep-fry pans, grillers, heaters for automobiles, communion wafer and waffle irons, electrically operated coffee percolators, leather pressing irons, toasters, heating equipment for aquariums, pressing irons.
85.13 A-----	Electrical apparatus for wire telephony and telegraphy other than equipment for high-frequency telephony, carrier communication apparatus, and water and explosionproof telephone apparatus.

*Quantitative restrictions on imports—Continued***AUSTRIA—Continued**

<i>Tariff No.</i>	
85.14 B.....	Electric amplifiers.
85.15 C.....	Radio and television receiving sets including console-type sets (combined with phonographs and tape recorders) except parts.
85.19 B.....	Switches and plugs of less than 0.3 kilogram of weight per unit; fuses of less than 0.3 kilogram of weight per unit; caps for fuses of less than 0.1 kilogram per unit.
85.20 A.....	Miniature lamps with a diameter of 18 millimeters or less
85.24.....	Carbon brushes complete with springs.
85.26.....	Insulating parts for electrical machinery, appliances and equipment, weighing 250 grams apiece or less, of other materials than hard rubber.
87.01 A.....	Wheel tractors, other than such with a capacity of 40-50 horsepower.
87.02.....	Radio receiving sets in liberalized motor vehicles.
87.04.....	Tractor chassis fitted with engines with a capacity of under 40 and over 50 horsepower.
87.08.....	Tanks and armored motor vehicles (parts are liberalized).
87.09 B.....	Motorized bicycles and bicycles with auxiliary motor, sidecars attached to such.
87.10.....	Cycles (including delivery tricycles) not motorized.
87.13 B.....	Baby carriages and their parts except wheels, wheel suspension, decorative hubcaps, and mudguards.
89.01.....	Boats made of plastic materials, inflatable and folding boats, made wholly or partly of plastic materials or rubber; racing and luxury boats, motorized; rafts and skiffs.
90.10 B.....	Boxes and bowls for the developing of photographic and cinematographic films; frames for slides and copies, spools; all these of plastic materials.
92.01.....	Keyboard stringed instruments, including automatic pianos; harps; other than; pianolas, pianophons, and phonolas.
92.02.....	Other string instruments.
92.03.....	Pipe and reed organs, including harmoniums but excluding mouth organs.
92.04.....	Accordions, concertinas, and similar musical instruments; mouth organs.
92.05.....	Wind instruments.
92.06.....	Percussion musical instruments.
92.07.....	Electromagnetic, electrostatic, electronic and similar musical instruments such as pianos and organs.
92.03.....	Musical instruments not falling within any preceding heading of this chapter (for example street organs, mechanical singing birds, musical saws); sound signaling instruments such as whistles, boatswains' pipes, decoy whistles, and the like, other than orchestrions, musical boxes with Swiss mechanism, twin-toned referees' whistles.
92.11.....	Music boxes.
94.01 A-1.....	Chairs and other seats, including convertible bed settees, and parts thereof, of wood.
94.01 A-2.....	Chairs and other seats, including convertible bed settees of other materials than metal whether or not in combination with wood and plastic materials.
94.01 B-1.....	Parts of chairs and other seats of wood other than seats of pressed wood.
94.01 B-3, 4.....	Parts of chairs and other seats of other materials than wood (94.01 B-1 above) and metal.
94.03.....	Other furniture and parts thereof, of any materials as for example wicker, oak, etc., except of nonprecious metals whether or not in combination with plastic materials, wood, glass, ceramic mosaic.

*Quantitative restrictions on imports—Continued***AUSTRIA—Continued**

<i>Tariff No.</i>	
94.04.....	Mattresses and mattress supports; quilts, eiderdowns, cushions, pillows, and similar bedding or furnishing, other than wired spring mattress supports.
96.01.....	Brooms of all kinds, merely bound, with or without handles.
96.02.....	Brushes and paintbrushes of all kinds except brushes of nonprecious metals other than iron and steel, brushes used in machines.
96.03.....	Prepared knots and tufts for brushmaking.
96.04.....	Feather dusters.
96.06.....	Hand sieves except sieves of nonprecious metals.
97.02 A.....	Polls except such of cellulose nitrate and cellulose acetate, not dressed.
97.03 B.....	Engines and coaches for toy trains, of sheet metal.
97.03 C.....	Other toys of wood, glass, ceramics, china, iron, plush and other materials except bathtowel racks, toy kitchen grinders and mincers, ranges and ethyl alcohol fueling, kitchen and grocery store equipment, bells, piggy banks, vacuum cleaners, telephones, scales and weights, washing machines and similar toys; dolls house furniture of materials other than wood; nonmechanic toy cars, automobile, aircraft and boat model kits, boxes of bricks of plastic materials chemical, technical, optical, physical, and radiotechnical experimental kits; chenille toys, glass pictures, toy watches and clocks, miniature modeling outfits of wood and plastic materials, modeling outlays, blueprints, etc., dolls, kitchen and tableware of china, pumping wells.
97.04 A.....	Billiard and roulette tables.
97.04 C.....	Other parlor and party games.
97.04 D.....	Parts for parlor and party games except table tennis rackets.
97.05 A.....	Christmas tree decorations except candlesticks.
97.05 B.....	Carnival and entertainment articles other than lent calendars, chenille toys, parts and figurines for Bethlehem scene, of paper, carnival novelties of paper, paper-board or china, conjuring kits.
97.06 C-2.....	Accessories and equipment (other than listed under 97-06 A through C1) for gymnastics, athletics, or for sports and outdoor games except badminton, Dhron and golf balls, football and handball inners with valve caps, hand fins of rubber, plastic balls with valves, toe-irons for skis, (ski) climbers.
97.09.....	Roundabouts and other fairground equipment, except circusses, animal shows, and travelling theaters.
98.01 A.....	Press studs.
98.01 B.....	Studs, buttons, cuff links and the like, and blanks therefor, of other materials than aluminum and aluminum alloys.
98.02.....	Slide fasteners (zippers); parts of slide fasteners of other than plastic materials.
98.03.....	Fountain pens, stylographs, ball point pens, penholders, pencil holders, propelling and sliding pencils, parts and fittings therefor, except fountain pens, styles, ball point pens, and parts thereof nonprecious metals; chalk holders of aluminum, replacements for ball point pens.
98.05.....	Pencils, pencil leads, crayons and pastels, drawing charcoal and writing and drawing chalk; tailors' and billiard chalk, other than slate pencils of all kinds.
98.09.....	Sealing wax, including bottle sealing wax, in small discs, bar or similar shape.
98.11 C.....	Smoking pipes, cigar and cigarette holders of other than ceramic materials and steatite; finished pipe bowls
98.11 D.....	Other parts of the aforementioned smoking utensils, except such of ceramic materials and steatite.
98.12.....	Fancy combs, hair slides, hair clips, and the like.

Quantitative restrictions on imports—Continued

BELGIUM AND LUXEMBOURG	
<i>Tariff No.</i>	
03.01 A II	Eels, fresh (live or dead) chilled or frozen.
03.02 A-B-C	Herrings, fillets, livers and roes of herrings salted or in brine, dried or smoked, not hermetically packed in cans or jars.
1513	Margarine, imitation lard, and other prepared edible fats.
27.01	Coal, whether or not agglomerated.
27.02	Lignite, whether or not agglomerated.
27.04 A II	Coke and semicoke of coal (not intended for the manufacture of electrodes).
29.14 A Xa	Palmitic acid.
29.14 A XIa	Stearic acid.
29.14 A XIIa	n-Hexoic acid and other higher fatty acids from natural fats, whether or not reproduced by synthesis or by any other process.
29.14 B IIIa	Oleic acid.
29.14 B IVa	Linoleic, linolenic, and other higher fatty acids from natural fats, whether or not reproduced by synthesis or by any other process.
29.44 A	Penicillin and its salts and other derivatives.
30.03 A IIa	} Medicaments, containing penicillin.
30.03 B IIa	
31.02 B	Mineral or chemical fertilizers, nitrogenous, excluding natural sodium nitrate.
01.01 EXA IIa	Foals for slaughter and other.
01.02 A and B	Bovine cattle for breeding and slaughter.
02.01 ex AI	Foal-fresh, fresh or chilled.
02.06 B	Bacon.
02.06 C	Preserved and prepared meat.
04.01	Milk and cream, fresh.
04.02	Milk and cream preserved, concentrated or sweetened.
06.03 A	Cut flowers and buds of a kind suitable for bouquets, fresh.
07.01	Leeks.
07.01 S	Celery.
07.05	Dried leguminous vegetables.
08.06	Fresh apples.
12.04 A	Sugarbeets.
12.05	Chicory roots.
12.06	Hops, cones, and lupin.
15.07 B IIa	Crude and other than crude olive oil.
15.13	Margarine, imitation lard and other prepared edible fats.
16.01	Sausages.
19.07	Bread.
CANADA	
04.03	Butter.
04.02	Butterfat, any form of butterfat either alone or in combination with other substances but excluding concentrated milk products, cheese, and any combination in which the presence of the other substances renders the combination unsuitable for use as a butterfat ingredient.
04.04	Cheddar cheese.
04.02	Dry skimmed milk.
FRANCE	
01.02	Live animals of the bovine species.
01.04	Live sheep and goats.
02.01	Meat and edible offals of the animals falling within heading No. 01.01, 01.02, 01.03, or 01.04, fresh chilled, or frozen.
02.06	Meat and edible meat offals (except poultry liver), salted, in brine, dried or smoked.
03.01	Fish, fresh (live or dead), chilled or frozen.
03.02	Fish, salted, in brine, dried or smoked.
04.01	Milk and cream, fresh, not concentrated or sweetened.
04.02	Milk and cream, preserved, concentrated or sweetened.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	FRANCE—Continued
05.15-----	Animal products not elsewhere specified or included; dead animals of chapter 1 or chapter 3, unfit for human consumption.
06.01-----	Bulbs, tubers, tuberous roots, corns, crowns, and rhizomes, dormant, in growth or in flower.
06.02-----	Other live plants, including trees, shrubs, bushes, roots, cuttings and slips.
06.03-----	Cut flowers and flower buds.
07.01-----	Vegetables, fresh or chilled: Potatoes. Cauliflower. Spinach. Salad vegetables, including chicory (blanched) and endives: Head lettuce. Other: other. Leguminous vegetables: beans. Carrots, turnips, salad beetroot, salsify, celeriac, and other edible roots: Carrots and turnips: carrots. Onions, shallots and garlic. Artichokes. Tomatoes. Olives and capers. Cucumbers and gherkins. Mushrooms and truffles. Other: aubergines, marrows, pumpkins and the like.
07.02-----	Vegetables (whether or not cooked), preserved by freezing.
07.03-----	Vegetables provisionally preserved in brine, in sulfur water or in other preservative solutions, but not specially prepared for immediate consumption: olives and capers.
07.04-----	Dried, dehydrated, or evaporated vegetables, whole, but sliced, broken or in powder, but not further prepared: Onions. Other, potatoes (excluding the products falling within heading No. 11.05). Other, of one variety or mixed (julienne).
08.01-----	Dates, bananas, coconuts, Brazil nuts, cashew nuts, pineapples, avocados, mangoes, guavas, and mangosteens, fresh or dried, shelled or not.
08.03-----	Figs, fresh or dried.
08.06-----	Apples, pears, and quinces, fresh.
08.07-----	Stone fruit, fresh.
08.08-----	Berries, fresh.
08.09-----	Other fruit, fresh: Melons and the like.
08.10-----	Fruit (whether or not cooked), preserved by freezing, not containing added sugar.
08.11-----	Fruit provisionally preserved in brine, in sulphur water, or in other preservative solutions, but not specially prepared for immediate consumption: Apricots, oranges, other: Except cherries.
08.12-----	Fruit, dried, other than that falling within heading Nos. 08.01, 08.02, 08.03, 08.04, or 08.05: Prunes: Imported in containers of a net weight less than 50 kilograms. Fruit salad. Other.
09.01-----	Coffee, whether or not roasted or freed of caffeine; coffee husks and skins; coffee substitutes containing coffee in any proportion.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	FRANCE—Continued
09.04.....	Pepper of the genus <i>Piper</i> ; pimento of the genus <i>Capsicum</i> and of the genus <i>Pimenta</i> : Neither crushed nor ground: Pepper. Crushed or ground: Pepper.
09.10.....	Thyme, saffron, and bay leaves; other spices: Other spices, including mixtures complying with the definition in note I(b) to the present chapter: All mixtures containing pepper.
11.02.....	Cereal groats and cereal meal; other worked cereal grains (for example, rolled, flaked, polished, pearled or kibbled, but not further prepared), except husked, glazed, polished, or broken rice; germ of cereals, whole, rolled, flaked or ground.
11.05.....	Flour, meal and flakes of potato: Other.
12.04.....	Sugarbeet, whole or sliced, fresh, dried or powdered; sugarcane.
12.05.....	Chicory roots, fresh or dried, whole or cut, unroasted.
12.06.....	Hop cones and lupulin.
13.03.....	Vegetable saps and extracts; pectin; agar-agar and other natural mucilages and thickeners extracted from vegetable materials.
16.01.....	Sausages and the like, of meat, meat offal, or animal blood.
16.04.....	Prepared or preserved fish, including caviar and caviar substitutes.
17.02.....	Other sugars; sugar sirups; artificial honey (whether or not mixed with natural honey); caramel.
17.03.....	Molasses, whether or not decolorized.
17.04.....	Sugar confectionery, not containing cocoa.
17.05.....	Flavored or colored sugars, sirups and molasses, but not including fruit juices containing added sugar in any proportion.
18.06.....	Chocolate and other food preparations containing cocoa.
19.03.....	Macaroni, spaghetti, and similar products.
19.05.....	Prepared foods obtained by the swelling or roasting of cereals or cereal products (puffed rice, corn flakes, and similar products).
19.07.....	Bread, ships' biscuits, and other ordinary bakers' wares, not containing sugar, honey, eggs, fats, cheese or fruit.
19.08.....	Pastry, biscuits, cakes, and other fine bakers' wares, whether or not containing cocoa in any proportion.
20.01.....	Vegetables and fruit, prepared or preserved by vinegar or acetic acid, with or without sugar, whether or not containing salt, spices, or mustard.
20.02.....	Vegetables prepared or preserved otherwise than by vinegar or acetic acid: Mushrooms. Tomatoes. Asparagus. Sauerkraut. Capers and olives. Other vegetables: Green peas, French beans, carrots, mixed vegetables. Other: In airtight containers or in other containers of a gross weight of 10 kilograms or less.
20.04.....	Fruit, fruit-peel, and parts of plants, preserved by sugar (drained, glace or crystallized).
20.05.....	Jams, fruit jellies, marmalades, fruit puree and fruit pastes, being cooked preparations, whether or not containing added sugar.
20.06.....	Fruit otherwise prepared or preserved whether or not containing added sugar or spirit.
20.07.....	Fruit juices (including grape must) and vegetable juices, whether or not containing added sugar, but unfermented and not containing spirit.

*Quantitative restrictions on imports—Continued***FRANCE—Continued**

<i>Tariff No.</i>	
21.01-----	Roasted chicory and other roasted coffee substitutes; extracts, essences, and concentrates thereof.
21.02-----	Extracts, essences, or concentrates, of coffee, tea, or mate; preparations with a basis of those extracts, essences or concentrates.
21.07-----	Food preparations not elsewhere specified or included.
22.04-----	Grape must, in fermentation or with fermentation arrested otherwise than by the addition of alcohol.
22.05-----	Wine of fresh grapes; grape must with fermentation arrested by the addition of alcohol.
22.09-----	Spirits (other than those of heading No. 22.08); liqueurs and other spirituous beverages; compound alcoholic preparations (known as concentrated extracts) for the manufacture of beverages.
22.10-----	Vinegar and substitutes for vinegar.
27.01-----	Coal.
27.02-----	Lignite.
27.04-----	Coke and semicoke.
27.05 bis-----	Coal gas.
27.07-----	Oils and other products of the distillation of high-temperature coal tar; other oils and products as defined in note 2 to this chapter.
27.09-----	Petroleum and shale oils, crude.
27.10-----	Petroleum oils, other than crude.
27.11-----	Petroleum gases and other gaseous hydrocarbons.
27.12-----	Petroleum jelly.
27.13-----	Paraffin wax, microcrystalline wax, slack wax, ozokerite, lignite wax, peat wax, and other mineral wax, whether or not colored.
27.14-----	Petroleum bitumen, petroleum coke, and other petroleum and shale oil residues.
27.16-----	Bituminous mixtures.
27.17-----	Electric current.
34.03-----	Lubricating preparations consisting of mixtures of oils or fats of all kinds.
34.04-----	Artificial waxes.
38.14-----	Anti-knock preparations, oxidation inhibitors.
38.19-----	Chemical products and preparations of the chemical or allied industries: Mixed alkylenes.
48.01-----	Paper and paperboard (including cellulose wadding) machine made, in rolls or sheets.
85.21-----	Electric lamps, tubes, and valves.
87.08-----	Tanks and other armored fighting vehicles, motorized, whether or not fitted with weapons, and parts of such vehicles.
88.02-----	Flying machines, gliders, and kites; rotochutes.
88.03-----	Parts of goods falling in heading No. 88.01 or 88.02.
89.01-----	Ships, boats, and other vessels not falling within any of the following headings of this chapter.
89.02-----	Tugs.
91.01-----	Pocket watches, wristwatches and other watches.
91.02-----	Clocks with watch movements (excluding clocks of heading No. 91.03).
91.03-----	Instrument panel clocks and clocks of a similar type, for vehicles, aircraft, or vessels.
91.07-----	Watch movements (including stopwatch movements), assembled.
91.09-----	Watch cases and parts of watch cases, including blanks thereof.
91.11-----	Other clock and watch parts.
39.07-----	Articles of materials of the kinds described in headings Nos. 39.01 to 39.06.
50.09-----	Woven fabrics of silk or of waste silk other than noil.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	FRANCE—Continued
51.04-----	Woven fabrics of manmade fibers (continuous); including woven fabrics of monofil or strip of heading No. 51.01 or 51.02.
53.11-----	Woven fabrics of sheep's or lambs' wool or of fine animal hair.
55.07-----	Cotton gauze.
55.08-----	Terry toweling and similar terry fabrics, of cotton.
55.09-----	Other woven fabrics of cotton.
56.07-----	Woven fabrics of manmade fibers (discontinuous or waste).
58.02-----	Other carpets, carpeting, rugs, mats and matting, and "Kelem," "Schumacks," and "Karamanie" rugs and the like (made up or not).
58.04-----	Woven pile fabrics and chenille fabrics (other than terry toweling or similar terry fabrics of cotton falling within heading No. 55.08 and fabrics falling within heading No. 58.05).
58.05-----	Narrow woven fabrics and narrow fabrics (bolduc) consisting of warp without weft assembled by means of an adhesive, other than goods falling within heading No. 58.06.
59.05-----	Nets and netting made of twine, cordage, or rope, and made up fishing nets of yarn, twine, cordage, or rope.
60.02-----	Gloves, mittens, and mitts, knitted or crocheted, not elastic or rubberized.
60.03-----	Stockings, understockings, socks, sockettes, and the like, knitted or crocheted, not elastic nor rubberized.
60.04-----	Undergarments, knitted or crocheted, not elastic nor rubberized.
60.05-----	Outer garments and other articles, knitted or crocheted, not elastic nor rubberized.
61.01-----	Men's and boys' outer garments.
61.02-----	Women's, girls', and infants' outer garments.
61.03-----	Men's and boys' undergarments, including collars, shirt fronts, and cuffs.
61.04-----	Women's, girls', and infants' undergarments.
61.05-----	Handkerchiefs.
61.06-----	Shawls, scarves, mufflers, mantillas, veils, and the like.
61.07-----	Ties, bow ties, and cravats.
61.09-----	Corsets, corset belts, suspender belts, brassieres, braces, suspenders, garters, and the like (including such articles of knitted or crocheted fabric), elastic or not.
62.01-----	Traveling rugs and blankets.
62.02-----	Bed linen, table linen, toilet linen, and kitchen linen; curtains and other furnishing articles.
63.01-----	Clothing, clothing accessories, traveling rugs and blankets, household linen and furnishing articles (other than articles falling within heading No. 58.01, 58.02, or 58.03), of textile materials, footwear and headgear of any material, showing signs of appreciable wear and imported in bulk, bales, sacks, or similar bulk packings.
64.01-----	Footwear with outer soles and uppers of rubber or artificial plastic material.
64.02-----	Footwear with outer soles of leather or leather substitutes; footwear (other than footwear falling within heading No. 64.01) with outer soles of rubber or artificial plastic material.
65.01-----	Hat forms, hat bodies, and hoods of felt, neither blocked to shape nor with made brims; plateaux and manchons (including slit manchons), of felt.
65.02-----	Hat shapes, plaited or made from plaited or other strips of any material, neither blocked to shape nor with made brims.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	FRANCE—Continued
65.03-----	Felt hats and other felt headgear, being headgear made from the felt hoods and plateaux falling within heading No. 65.01, whether or not lined or trimmed.
65.05-----	Hats and other headgear (including hair nets), knitted or crocheted, or made up from lace, felt, or other textile fabric in the piece (but not from strips), whether or not lined or trimmed.
65.06-----	Other headgear, whether or not lined or trimmed.
70.19-----	Glass beads, imitation pearls, imitation precious and semiprecious stones, fragments and clippings, and similar fancy or decorative glass smallwares, and articles of glassware made therefrom; glass cubes and small glass plates, whether or not on a backing, for mosaics and similar decorative purposes; artificial eyes, of glass, including those for toys but excluding those for wear by humans; ornaments and other fancy articles of lamp-worked glass; glass grains (ballotini).
71.12-----	Articles of jewelry and parts thereof, of precious metal or rolled precious metal.
71.13-----	Articles of goldsmiths' or silversmiths' wares and parts thereof, of precious metal or rolled precious metal, other than goods falling within heading No. 71.12.
71.15-----	Articles consisting of, or incorporating, pearls, precious or semiprecious stones (natural, synthetic or reconstructed).
71.16-----	Imitation jewelry.
85.03-----	Primary cells and primary batteries.
85.10-----	Portable electric battery and magneto lamps, other than lamps falling within heading No. 85.09.
85.15-----	Radiotelegraphic and radiotelephonic transmission and reception apparatus, etc.
85.21 C, 85.21 E I..	Crystal diodes, crystal triodes and other crystal valves, including transistors, and parts thereof.
90.05-----	Binoculars, prismatic or not.
90.12-----	Compound optical microscopes, whether or not provided with means for photographing or projecting the image.
91.01, 91.02, 91.03, 91.04, 91.07, 91.08, 91.09, 91.11.	Clocks and watches and parts thereof coming under the items opposite.
92.11-----	Gramophones, dictating machines and other sound recorders and reproducers, including record players and tape-decks with or without soundheads.
94.03-----	Other furniture and parts thereof.
96.02-----	Other brooms and brushes (including brushes of a kind used as parts of machines); paint rollers; squeegees (other than roller squeegees) and mops; Tooth brushes, shaving brushes, drawing and paint brushes.
96.03-----	Prepared knots and tufts for broom or brushmaking.
97.02-----	Dolls.
97.03-----	Other toys; working models of a kind used for recreational purposes (entire item).
98.01-----	Buttons and button molds, studs, cuff links, and press-fasteners, including snap-fasteners and press-studs; blanks and parts of such articles.
98.03-----	Fountain pens, stylograph pens and pencils (including ball point pens and pencils) and other pens, penholders, pencilholders and similar holders, propelling pencils and sliding pencils; parts and fittings thereof, other than those falling within heading No. 98.04 or 98.05.
98.05-----	Pencils (other than pencils of heading No. 98.03), pencil leads, slate pencils, crayons and pastels, drawing charcoal and writing and drawing chalks; tailors' and billiards chalks.

Quantitative restrictions on imports—Continued

GERMANY

<i>Tariff No.</i>	
2701	Coal.
2704	Coke.
4102 31	Bottom leather of cattle, undressed.
4102 39	Other leather of cattle, undressed.
4102 51	Bottom leather of cattle, undressed.
4102 52	Upper leather of cattle, undressed.
4102 57	Dressed neat's leather.
4102 59	Other leather of cattle, undressed.
0102 12	Calves, live.
0102 15	Calves, for slaughter.
0102 16	Young cattle, male, live.
0102 17	Young cattle, female, live.
0102 25	Young cattle, for slaughter.
0102 35	Steers, for slaughter (bulls).
0102 42	Cows, for general use.
0102 45	Cows, for slaughter.
0102 51	Oxen, for general use.
0102 55	Oxen, for slaughter.
0104 21	Lambs, for general use.
0104 25	Lambs, for slaughter.
0104 31	Sheep other than lambs, for general use.
0104 35	Sheep other than lambs, for slaughter.
0201 12	Part of loin (for rib pork chop), fresh or chilled.
0201 13	Unrendered pig fat, fresh or chilled.
0201 19	Other pork of domesticated hogs, fresh or chilled.
0201 22	Part of loin (for rib pork chop), frozen.
0201 23	Unrendered pig fat, frozen.
0201 29	Other pork of domesticated hogs, frozen.
0201 31	Veal, fresh or chilled.
0201 32	Halves and quarters of cattle, fresh or chilled.
0201 33	Loin cuts, fresh or chilled.
0201 39	Other beef, fresh or chilled.
0201 41	Veal, frozen.
0201 42	Halves and quarters of cattle, frozen.
0201 43	Loin cuts, frozen.
0201 49	Other beef, frozen.
0201 51	Mutton, fresh or chilled.
0201 55	Mutton, frozen.
0201 93	Edible offals of hogs, fresh, chilled, or frozen.
0201 95	Edible offals of cattle, fresh, chilled, or frozen.
0201 99	Edible offals of sheep and lambs, fresh, chilled, or frozen.
0205	Unrendered pig fat, not containing lean meat:
0205 11	Fresh or chilled.
0205 13	Frozen.
0205 15	Salted only.
0205 17	In brine, dried or smoked.
0205 30	Lard, neither pressed nor rendered.
0206 11	Ham of domesticated hogs, salted, in brine, dried, or smoked.
0206 13	Pig fat, containing lean meat, salted only.
0206 19	Pork, other than ham and bacon, of domesticated hogs, salted, in brine, dried, or smoked.
0206 20	Beef and veal, salted, in brine, dried, or smoked.
0206 50	Mutton and lamb, salted, in brine, dried, or smoked.
0206 91	Edible offals of domesticated hogs, salted, in brine, dried, or smoked.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	GERMANY—Continued
0206 99-----	Edible offals of cattle, calves, sheep, salted, in brine, dried or smoked.
0301 35-----	Carp, fresh or chilled.
0302 19-----	Fillets of herring, only salted or in brine.
0302 51-----	Herring, salted or in brine.
0401 10-----	Whole milk and skim milk, fresh.
0401 20-----	Buttermilk, whey, sour milk, etc., fresh.
0401 50-----	Cream, fresh.
0402 11-----	Whole milk, powdered.
0402 13-----	Skim milk, powdered.
0402 19-----	Other milk, preserved, concentrated, or sweetened.
0402 20-----	Other (e.g. condensed milk).
0403 10-----	Butter.
0403 50-----	Butter oil.
0404 11-----	Hard cheese.
0404 16-----	Other cheese for cutting.
0404 60-----	Processed cheese and cheese preparations.
0515 10-----	Small fish, up to a length of 6 centimeters, de facto dried, inedible.
0515 20-----	Crabs, dried, inedible.
0515 50-----	Animals, not live, inedible, other than dried small fish, crabs, and water fleas.
0515 90-----	Other products of animal origin, except formic eggs.
0602 55-----	Azalea indica, with flowers or buds.
0602 57-----	Other azaleas, with flowers or buds.
0602 59-----	Apple trees on root stocks and seedlings.
0603 11-----	Carnations, fresh.
0603 12-----	Rose, fresh.
0603 13-----	Flowers from bulbs, fresh.
0603 19-----	Other flowers, fresh.
0701 14-----	Tomatoes, fresh or chilled.
0701 25-----	Potatoes for seed, fresh or chilled.
0701 26-----	Potatoes for food.
0701 29-----	Potatoes for industrial purposes, except for the manufacture of starch or potato flakes, under customs bond.
0701 41-----	Cauliflower, fresh or chilled.
0701 51-----	Head lettuce, fresh or chilled.
0701 52-----	Endive salad, fresh or chilled.
0701 71-----	Beans, fresh or chilled.
0701 81-----	Small cucumbers, fresh or chilled.
0701 85-----	Other types of cucumbers, fresh or chilled.
0704 90-----	Potatoes, powdered, or otherwise chopped.
0705 11-----	Garden beans (<i>phaseolus</i> species), for seed.
0705 21-----	Other beans, for seed (<i>vicia faba</i> var. <i>minor</i>).
0705 22-----	Other beans, for seed (<i>vicia faba</i> var. <i>megalosperma</i>).
0705 31-----	Peas, for seed.
0705 41-----	Fodder peas, for seed.
0806 19-----	Apples, other than for must, fresh.
0806 39-----	Pears, other than for must, fresh.
0807 40-----	Fresh plums.
1006 10-----	Paddy.
1006 51-----	Cargo rice.
1006 55-----	Milled rice.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	GERMANY—Continued
1006 91	Broken rice, not polished.
1006 95	Broken rice, polished.
1102	
1105 00	Flour, grits, and flakes of potatoes.
1203 11	Seeds of sugarbeets.
1203 19	Seeds of fodder beets.
1203 27	Seeds of white cloves.
1203 41	Seeds of English Ray grass (<i>lolium perenne</i>).
1203 42	Seeds of Italian Ray grass (<i>lolium multiflorum italicum</i>).
1203 45	Seeds of Brazil Ray grass (<i>lolium multiflorum var. brasili- num</i>).
1203 46	Seeds of French Ray grass (<i>arrhenatherum elatius</i>).
1203 47	Seeds of timothy grass (<i>phleum pratense</i>).
1203 48	Seeds of grass (<i>dactylis glomerata</i>).
1203 53	Seeds of grass (<i>festuca pratensis</i>).
1203 54	Seeds of grass (<i>festuca rubra</i>).
1204 19	Subarbeets, also chips, other than fresh.
1210 95	Alfalfa, dried and ground.
1501 01	Lard, for human consumption.
1504 71	Whale oil and whale fat, for human consumption, refined.
1504 91	Other marine fats and oils, for human consumption, refined.
1507 03	Cotton seed oil, processed, for human consumption.
1507 07	Oil of beechnut, corn, and poppy seed, processed, for human consumption.
1507 13	Peanut oil, processed, for human consumption.
1507 23	Coconut oil, processed, for human consumption.
1507 27	Linseed oil, processed, for human consumption.
1507 37	Palmkernel oil, processed, for human consumption.
1507 47	Rape and colzar oil, processed, for human consumption.
1507 53	Safflower oil, processed, for human consumption.
1507 57	Sesame oil, processed, for human consumption.
1507 63	Soya oil, processed, for human consumption.
1507 67	Sunflowerseed oil, processed, for human consumption.
1507 97	Other fatty vegetable oils, processed, for human consump- tion.
1512 11	Whale oil, edible without further processing.
1512 17	Whale oil, for human consumption, hydrogenated, also refined.
1512 21	Fish oil, edible without further processing.
1512 27	Fish oil, for human consumption, hydrogenated, also refined.
1512 51	Other fats and oils, edible without further processing.
1512 57	Other fats and oils of animals, for human consumption, hydrogenated, also refined.
1512 81	Vegetable fats and oils, edible without further processing.
1512 87	Other vegetable fats and oils, for human consumption, hydrogenated, also refined.
1513 10	Margarine.
1513 90	Shortening and other processed edible fats.
1601	Sausages and the like of meat, offals of animal blood from cattle, hogs, sheep:
1601 19	With liver.
1601 90	Without liver.
1602 19	Meat and offals, otherwise prepared or preserved, of cattle, hogs, sheep; with liver.
1602	Meat and offals, otherwise prepared or preserved; without liver:
1602 50	Of cattle.
1602 61	Of hogs: ham.
1602 69	Of hogs, other than ham.
1602 90	Of sheep and lambs.
1603 00	Meat extracts and meat juices.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	GERMANY—Continued
1701 15	Beet sugar, raw, solid.
1701 31	Candy sugar, and brown sugar.
1701 39	Other sugar for human consumption.
1702 10	Artificial honey, also mixed with natural honey.
1702 99	Other sugar and sirup (maltose, invert sugar, etc.).
1703 00	Molasses, also decolorized.
1705 10	Vanille sugar.
1705 90	Aromatic or colored sugar, sirup and molasses, other than vanille sugar, with a purity of more than 70°.
1806 50	See cream.
1902 10	Food preparations for infants based on flour or starch.
1902 30	Special types of flour for food preparations (Quellmehle).
1902 50	Powder for the preparation of puddings and the like, also containing cocoa.
1902 91	Other food preparations with sugar or cocoa added.
1902 99	Other food preparations without sugar or cocoa.
1903 00	Macaronis, noodles, and the like.
2001 10	Cucumbers, preserved in vinegar, canned.
2001 90	Other vegetables preserved in vinegar, in airtight containers, except olives.
2002	Vegetables and pot-herbs, preserved without vinegar, in containers weighing less than 5 kilos:
2002 55	Peas.
2002 56	Beans.
2002 59	Other vegetables and pot-herbs, also mixed (except artichokes and spinach).
2004	Fruits and plants, and parts thereof, preserved with sugar:
2004 51	Cherries.
2004 59	Other fruits, plants and parts thereof.
2005 10	Applesauce.
2005 95	Jams, jellies, marmalades, etc., with sugar or sirup, but other than of apples, plums, quinces, and bitter orange marmalade.
2006	Fruits, prepared or preserved otherwise, also with sugar or alcohol, in containers weighing less than 5 kilos:
2006 75	Strawberries.
2006 79	Figs.
2007 13	Fruit juice concentrates of apples or pears, without sugar, also mixtures thereof.
2007 23	Fruit juices of apples or pears, without sugar, also mixtures thereof.
2101 50	Roasted coffee substitutes made of grain.
2105 10	Preparations on the basis of meat or meat extracts of cattle, hogs, or sheep, for the production of soups and broths.
2107 20	Ice cream and ice cream powder.
2205 10	Champagne.
2205 23	Wine for the production of champagne.
2205 51	Red wine in containers of more than 2 liters.
2205 59	Red wine in containers up to 2 liters.
2205 61	White wine in containers of more than 2 liters.
2205 69	White wine in containers up to 2 liters.
2205 90	Wine, other than red and white wine (e.g., dessert wine).
2210 00	Vinegar for food.
2301 10	Fish meal, including fish liver meal, inedible.
2301 20	Greaves and greave cake and similar residues from whale-oil boiling, inedible.
2301 90	Other residues of fish, and meat meal, inedible.
2303 10	Beet pulps and other residues from the production of sugar.
2307 99	Fodder preparations, mainly of inorganic substances (e.g. mixtures of feed lime and mineral salts).
3501 11	Casein, not hardened, for food and feed.

Quantitative restrictions on imports—Continued

ITALY	
<i>Tariff No.</i>	
01.02.....	Live cattle for slaughter.
02.01.....	Fresh, refrigerated and frozen pork and beef and pork offals and salted, in brine, dried, or smoked.
02.06.....	Pork and edible offals thereof salted, in brine, dried or smoked.
04.01.....	Milk and cream, fresh.
04.02.....	Milk and cream, preserved, concentrated, or sweetened.
04.03.....	Butter.
04.04.....	Cheese and curd.
08.01.....	Dates in packages of more than 500 grams.
08.03.....	Figs, dried, except those in packages weighing 500 grams or more.
08.04.....	Fresh grapes, wine, dried grapes (raisins).
12.04.....	Sugarbeets, not fresh, except those used for manufacture of coffee substitutes.
12.08.....	Locust beans, whole, kibbled, or ground.
15.07.....	Soya oil.
15.10.....	Acid oils from refining, etc.
15.17.....	Oil foots and dregs; decolorising earths and carbons containing fats.
15.17b.....	Soap stocks.
17.01.....	Beet sugar and cane sugar, solid.
17.02.....	Saccharose syrup.
17.03.....	Molasses.
17.05.....	
20.05.....	Date paste, paste of dried figs or raisins.
20.07.....	Fruit juices (including grape must) and vegetable juices, whether or not containing added sugar, but unfermented and not containing spirit, except grapefruit and pineapple juice.
22.04.....	Grape must in fermentation, etc.
22.05.....	Wine of fresh grapes; grape must with fermentation arrested by the addition of alcohol.
33.01 A I.....	Essential citrus oil other than terpenless.
25.03.....	Sulfur of all kinds, other than sublimed sulfur, precipitated sulfur and colloidal sulfur, other.
25.01.....	Carbon salt.
28.02.....	Sulfur, sublimed or precipitated; colloidal sulfur.
29.16.....	Citric acid and crude calcium citrate.
29.34.....	Tetraethyl lead.
33.01.....	Essential oils, concrete or absolute, from citrus fruit.
38.14.....	Antiknock preparations based on tetraethyl lead.
45.01-45.02.....	Natural cork, unworked, crushed, granulated, or ground; waste cork; blocks, plates, sheets, etc.
71.07.....	
71.12, 71.13, 71.14...	Semifinished gold alloys (excluding platinum-plated gold), except gold sheet in special alloys for dental work and gold foil strip for hot gilding, laminated with film rolls. Articles of jewelry and parts thereof, articles of goldsmiths' wares, and parts thereof, and other articles of gold, including platinum-plated gold with covering layer not thicker than 30 microns.

JAPAN

0101.....	Horses (excluding asses, mules, and hinnies).
0102.....	Bovine cattle (excluding buffaloes).
0103.....	Swine.
0201-1.....	Beef and veal, fresh or frozen (excluding internal organs and tongues).
0201-2.....	Pork, fresh or frozen (excluding internal organs and tongues).
0205.....	Unrendered pig fat free of lean meat, fresh frozen, salted in brine, dried, or smoked.

*Quantitative restrictions on imports—Continued***JAPAN—Continued**

<i>Tariff No.</i>	
0206-1	Ham and bacon.
0206-2	Beef and veal, and pork, salted in brine, dried or smoked.
0301-2-(2)	Herring, cod (including Alaska codfish) and their roe, and yellow-tail, mackerel, sardines, horse-mackerel, and sauries, fresh or frozen.
0302-1	Roe of cod (including Alaska codfish) and herring, salted in brine, dried, or smoked.
0302-2-(1)	Cod (including Alaska codfish), herring, yellow-tail, mackerel, sardines, salted in brine, dried or boiled and dried.
0302-2-(2)	Cod (including Alaska codfish), herring, mackerel, sardines, yellow-tail, horse-mackerel and sardines, smoked.
0303-2-(1)	Scallops, ligament of scallops and cattle fish, fresh or frozen.
0303-2-(2)	Scallops, ligament of scallops and cattle fish, salted in brine, dried or smoked.
0401	Fresh milk and cream (pasteurized or cream not less than 13 percent fatty contents).
0402	Milk and cream, preserved, concentrated, or sweetened.
0403	Butter.
0404-1	Processed cheese.
0404-2	Cheese and curd, other (excluding natural cheese).
0706	Manioc, arrowroot, sweet potatoes, jerusalem artichokes, and other similar roots and tubers with high starch or inulin content, fresh or dried, whole or sliced (excluding fresh sweet potatoes; sago pith).
0801-3	Dates, dried.
0802-1	Lemons and lime, fresh.
0802-2	Oranges, fresh.
0802-3	Grape fruits, fresh.
0802-4	Tangerines, fresh.
0804-1	Grapes (<i>vitis vinifera</i>).
0806	Apples, fresh.
0810	Pineapples, preserved by freezing (including baked and boiled).
0901-1-(2)	Coffee, other (excluding those in containers, less than 400g by one case).
0902-1-(1)	Black tea, put up for sale by retail.
0902-1-(3)	Black tea, other.
1001	Wheat and meslin.
1003	Barley.
1006	Rice.
1007-3	Kao-liang and other grain sorghums (excluding those procured by Government).
1101-1	Wheat flour.
1102-2	Wheat, barley, and Kao-liang and other grain sorghums, groated, polished, or similarly worked.
1104	Flours of the fruit falling within any heading in chapter 8 of the customs tariff.
1105	Flour, meal, and flakes of potato.
1106	Flour and meal of sago and of manioc, arrowroot, and other roots and tubers falling within heading No. 0706.
1107	Malt, roasted or not.
1108	Starches and inuline.
1109	Gluten and gluten flour, roasted or not.
1201-2	Ground nuts.
1201-3	Rapeseeds and mustard seeds.
1207-4	Coca leaves.
1207-11	Cannabis plant and poppy straw.
1303-10-(2)	Sapa, extracts and tincture of hemp; extract of opium and crude cocaine.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	JAPAN—Continued
1401-3.....	Rushes, Chinese matgrass (<i>Cyperus tegetiformis</i>), "Wan-guru" (<i>Cyperus exaltatus</i>) and similar vegetable materials of a kind suitable for manufacturing "tatamiomote" "goza" or similar mats and mattings.
1405-1.....	Amorphophallus tubers, whether or not cut, dried, or powdered.
1405-2-(1).....	Seaweeds, made into rectangular papery sheets not more than 430 square centimeters per piece, edible.
1405-2-(2).....	Genus <i>Porphyra</i> and other seaweeds mixed with genus <i>Porphyra</i> , edible, other than those falling within heading No. 1405-2-(1).
1405-2-(4).....	Other edible seaweeds (genus <i>Porphyra</i> , genus <i>Enteromorpha</i> , <i>Monostroma kjellmanjella</i> and <i>Laminaria</i>).
1405-4.....	Dates, denatured.
1507-1.....	Soya bean oil.
1507-2.....	Ground nuts oil.
1507-3.....	Rapeseed oil and mustard seed oil.
1507-5.....	Cotton seed oil (excl. for mayonnaise production).
1507-14.....	Corn oil, safflower seed oil, and sunflower seed oil.
1513-1.....	Margarine.
1513-2.....	Shortening.
1601.....	Sausages and the like, of meat (excluding those of fish, of crustaceans or molluscs).
1602.....	Corned beef and other meat preparations of beef, of pork meat and prepared foodstuffs mostly of these meat preparations.
1604-2.....	Cod roe (including Alaska codfish) and herring roe, prepared or preserved.
1702-1.....	Glucose not sugared.
1702-2.....	Maltose not sugared.
1702-3.....	Lactose not sugared (less than 90 percent lactose contents).
1702-4.....	Sugar sirup.
1702-5.....	Caramel.
1702-6.....	Artificial honey.
1702-7.....	Sugar and sirups of sugar, other.
1703.....	Molasses (excluding those falling within heading No. 1705); denatured molasses.
1704.....	Sugar confectionery, not containing cocoa.
1705.....	Flavored or colored sugars, sirups, and molasses, excluding sugared fruits juices.
1805.....	Cocoa powder, not sugared, weighing less than 2,260 grams net contents.
1806-1.....	Chocolate confectionery.
1806-2-(1).....	Powder, board, and ball of food preparation containing sugared cocoa powder, sheets, and lumps.
1902.....	Preparations of flour, starch, or malt extract, of a kind used as infant food or for dietetic or culinary purpose (cake mix).
1903.....	Macaroni, spaghetti, vermicelli, and noodles.
1904.....	Tapioca, sago, and similar prepared foods obtained from cereals.
1905.....	Puffed rice, cornflakes, and similar prepared food obtained from cereals (preparations of rice, wheat or barley, and cornflake).
1908-1.....	Cookies, biscuits, and crackers, sugared.
1908-2.....	Cookies, biscuits, and crackers, other.
2002-2-(1).....	Tomato puree and tomato paste.
2002-2-(2).....	Mashed potatoes and potato flakes.
2003.....	Pineapples, preserved by freezing, sugared.
2005.....	Fruit puree and fruit paste.
2006-1-(1).....	Pineapples, sugared or containing spirit.

Quantitative restrictions on imports—Continued

JAPAN—Continued

<i>Tariff No.</i>	
2006-1-(2)-----	Fruit pulp, sugared or containing spirit.
2006-2-(1)-----	Pineapples, other.
2006-2-(2)-----	Fruit pulp and roasted groundnuts, other.
2007-1-(1)-----	Fruit juices, sugared.
2007-1-(2)-----	Fruit juices, other (excluding sloe base).
2007-2-----	Tomato juices, the dry weight content of which is less than 7 percent.
2104-1-(1)-----	Tomato ketchup and tomato sauces.
2104-2-(2)-----	Seasoning, mostly of monosodium glutamate.
2107-1-----	Food preparations, sugared (excluding rations and peanut butters).
2107-2-(1)-----	Bases for beverage, nonalcoholic.
2107-2-(2)-----	Ice cream mix, infant foods, and other food preparations, mostly of milk; seaweed preparations (genus porphyra, enteromorpha, monostroma, laminaria and kjellmamiella).
2202-----	Lemonade, flavored spa water, and flavored aerated waters, and other nonalcoholic beverages, not including fruit and vegetable juices, but added fruit juices.
2204-----	Grape must, in fermentation or with fermentation arrested otherwise than by the addition of alcohol (including brandy and other distilled alcoholic beverages).
2205-----	Grape wines, including sherry, port and fortified wine, not elsewhere specified or included.
2206-----	Vermouths, and other grape wines flavored with aromatic extracts.
2208-----	Alcohol undenatured, of a strength of 80° or higher; denatured alcohol.
2209-1-(1)-----	Whisky.
2209-1-(2)-----	Brandy, including cognac.
2209-1-(3)-----	Gin.
2209-2-(1)-----	Liqueurs (excluding elixir Korea ginseng).
2301-----	Cakes, flours, and meals of fish; fish soluble and flours, meat of whale; unfit for human consumption.
2303-----	Bagasse; residues from the manufacture of starch from manioc tapioca, potatoes, and other similar roots and tubes, or sago.
2304-1-----	Soya bean cake and meal.
2304-2-----	Oil cake and meal of rapeseed or mustard seed.
2307-2-----	Mixed forage.
2401-----	Unmanufactured tobacco; tobacco refuse.
2402-1-----	Manufactured tobacco.
2402-2-----	Tobacco extracts.
2501-----	Common salt (excluding celery salt and other flavored or seasoning-added salts); pure sodium chloride; salt liquors.
2502-----	Iron pyrites.
2503-----	Sulfur, excluding insoluble sulfur.
2504-2-----	Natural graphite, amorphous.
2532-1-(1)-----	Natural sodium carbonate.
2532-1-(2)-----	Ores of radioactive elements.
2601-5-----	Tungsten ores.
2601-8-----	Gold ores and ores of the radioactive metals.
2603-2-----	Slag of radioactive elements, and gold.
2701-----	Coal; briquettes, ovoids, and similar solid fuels manufactured from coal.
2702-----	Lignite, whether or not agglomerated.
2704-----	Coke and semicoke of coal, of lignite or of peat.
2710-1-(1)-(A)-----	Petroleum spirits of aviation use, including products not containing antiknock preparations, excluding those in containers of a capacity less than 300 liters.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	JAPAN—Continued
2710-1-(1)-(B)-----	Other petroleum spirits in containers of a capacity exceeding 300 liters; excluding the following, hexanes, heptanes or similar solvents more than 75° C. of start point and not more than 135° C. of dry point, using for polymerization of propylene; polymerized products of propylene containing nonene or dodesene; mixed aromatic solvents (of a specific gravity from 0.81 to 0.85, and more than 140° C. of start point) containing more than 40 percent of aromatic substances.
2710-1-(2)-----	Lamp oil and white spirit excluding those in containers of a capacity less than 300 liters, and solvents for manufacturing insecticide; polymerized products of propylene containing dodesene; mixed aromatic solvents (of a specific gravity from 0.81 to 0.85, and more than 140° C. of start point and not more than 210° C. of dry point) containing more than 40 percent of aromatic substances.
2710-1-(3)-----	Gas oils, excluding those in containers of a capacity less than 300 liters.
2710-1-(4)-----	Heavy fuel oil and crude fuel oil, excluding, petroleum partly refined for further refining and those in containers of a capacity less than 300 liters.
2710-1-(6)-----	Other oil, excluding those in containers of a capacity less than 300 liters.
2711-----	Petroleum gas and other gaseous hydrocarbons, liquefied or not (excluding those in containers of a capacity less than 300 liters).
2819-----	Zinc oxide and zinc sesquioxide.
2827-----	Lead oxides.
2830-1-----	Ammonium chloride.
2842-1-----	Sodium carbonate.
2842-5-----	Basic lead carbonate.
2852-1-----	Inorganic or organic compound of thorium or uranium.
2856-1-----	Tantalum carbide.
2905-2-(1)-----	Menthol.
2913-1-(6)-----	Camphor.
2922-5-----	Methadone group synthetic narcotic drugs, aniline group synthetic narcotic drugs, phenylalphanaphthylamine and N-nitroso di-phenylamine.
2923-3-----	Sodium glutamate.
2925-1-----	Urea.
2935-7-----	Pethidine group synthetic narcotic drugs, methadone group synthetic narcotic drugs (only narcotic drugs having the morpholine nucleus), aminobutens group synthetic narcotic drugs, benzimidazole group synthetic narcotic drugs, morphinan group synthetic narcotic drugs, hen-zomorphan group synthetic narcotic drugs.
2942-1-----	Opium alkaloids and their derivatives (narcotic drugs).
2942-3-(3)-----	Ecgonine, cocaine, cocaine hydrochloride and cocaine sulphate.
2942-3-(6)-----	Compounds of ephedrine and ecgonine.
2943-1-----	Grape sugar.
2943-2-----	Malt sugar.
2943-4-----	Sorbose.
2943-5-----	Sugars, other.
2944-1-----	Penicillin and streptomycin.
2944-2-----	Antibiotics, other (chloramphenicol, tetracycline, erythromycin, cycloserine and griseofulvin).
3002-1-----	Vaccine (excluding yellow fever vaccine, distemper vaccine, combined distemper vaccine, milk enteritis vaccine, milk enteritis vaccine combined with clostretium botulinum type C toxoid).

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	JAPAN—Continued
3002-2-----	Immune serum (excluding distemper serum and combined distemper serum).
3003-1-(1)-----	Preparations of penicillin or streptomycin.
3003-1-(2)-----	Preparations with a basis of antibiotics, other (preparations of chloramphenicol, tetracycline, erythromycin, cycloserine and griseofulvin).
3003-3-----	Preparations of insulin (excluding lente insulin).
3003-4-----	Preparation containing phenylaminopropane, phenylmethylaminopropane or any of their salts; preparations of opium alkaloids or their derivatives (narcotic drugs); preparations of egonine, cocaine, cocaine hydrochloride or cocaine sulfate; preparations of methadone group synthetic narcotic drugs having the morpholine nucleus), aniline group synthetic narcotic drugs, pethidine group synthetic narcotic drugs, aminobutene group synthetic narcotic drugs, benzimidazole group synthetic narcotic drugs, morphinan group synthetic narcotic drugs or benzomorphan group synthetic narcotic drugs.
3102-1-----	Ammonium sulphate.
3102-4-----	Other fertilizers, nitrogenous.
3103-----	Mineral or chemical fertilizers, phosphatic (double superphosphate of lime).
3105-----	Composite and complex fertilizers (excluding hyponex).
3301-1-(3)-----	Peppermint oil (excluding mitcham grade spearmint oil) and residual oil of peppermint, and mustard oil.
3304-1-----	Fruit flavors of an alcoholic strength of 10 degrees or higher, containing fruit juices.
3304-2-----	Fruit flavors, other containing fruit juices.
3306-1-----	Perfumed water (including eau de Cologne).
3306-2-----	Face powder.
3505-----	Dextrines, soluble starches and starch glues.
3601-----	Propellent powders.
3602-----	Prepared explosives.
3603-----	Mining, blasting, and safety fused.
3604-----	Percussion and detonating caps; igniters and detonators, electric or not, excluding fuse.
3701-2-(1)-----	Dry plates, cut film, film packs and other plates, sensitized, unexposed, of glass or other materials (including film in the plate (color).
3701-2-(2)-----	Dry plates, cut film, film packs, and other plates, sensitized, unexposed, of glass or other materials (including film in the plat), other (for photolithography and reprint).
3702-1-(2)-----	Film in rolls for color photography.
3702-2-(1)-----	Cinematograph film, color.
3703-----	Sensitized paper, paperboard, and cloth, not developed.
3812-2-----	Dressing glues.
3819-7-----	Mixture of metal carbides containing tantalum carbide, not sintered by prepared for making plates sticks and the like for the tool-tips.
4102-----	Bovine animals leather and equine animals leather.
4103-1-----	Sheep skin leather, dyed, colored, stamped, or embossed.
4104-1-----	Goat skin leather, dyed, colored, stamped, or embossed.
4108-----	Patent leather.
4203-1-----	Articles of apparel, containing furskin or combined or trimmed with precious metals, rolled precious metals, metals plated with precious metals, precious stones, semiprecious stones, pearls, coral, elephant's ivory, or "bekko."
4203-2-----	Articles of apparel, other.
4402-----	Wood charcoal other than nut charcoal.
4405-4-----	Lumbers, lauans, and apitons.
4414-2-----	Veneer sheets and sheets for plywood, lauans, and apitons.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	JAPAN—Continued
4415-----	Plywood and veneered panels of lauan and apitons whether or not containing artificial plastic materials, base metals or any other materials; inlaid wood and wood marquetry.
4602-1-----	Straw mats ("Mushiro").
4603-2-----	Straw bags.
4809-----	Building board of pulp or of vegetable fiber, whether or not bonded with natural or artificial resins or with similar binders.
5101-----	Yarn of manmade fibers (continuous), containing more than 50 percent by weight of synthetic fibers (excluding polyvinyl alcohol, polyvinyl chloride, and vinylidene), or acetate fibers.
5311-1-----	Woven fabrics (other than waste) containing more than 30 percent by weight of sheep's or lambs' wool or of fine animal hair, excluding those used for pianos.
5402-----	Ramie, raw or processed but not spun, including noils, pulled or granetted rags, and yarn waste.
5403-----	Flax or ramie yarn, not put up for retail sale.
5405-----	Woven fabrics of flax or of ramie.
5506-----	Cotton yard, put up for retail sale.
5604-1-----	Man made fibers (discontinuous or waste), carded or combed, containing more than 50 percent by weight of synthetic fibers (excluding polyvinyl alcohol, polyvinyl chloride and vinylidene) or acetate fibers.
5809-----	Tulle and other net fabrics, figures; lace, in the piece, in strips or in motifs; wholly of cotton, wool, flax, ramie, synthetic fibers (excluding polyvinyl alcohol, polyvinyl chloride and vinylidene) or acetate fibers, or consisting wholly of a combination of 2 or more of those fibers, with or without other fibers.
5810-----	Embroidery, in the piece, in strips, or in motifs, except those embroidered on handkerchiefs, tablecloths, dresses, and similar articles.
6405-1-----	Parts of footwear of leather.
7006-----	Glass (specified in headings Nos. 7004 and 7005), surface ground or polished, other than glass falling within heading No. 7007.
7019-----	Noncolored transparent diamond-cut imitation jewelry of glass, having 9 or more cuttings on upper face and 8 or more cuttings on under face; including plated with silver on under face; but not including coated with lacquer.
7103-2-----	Synthetic precious or semiprecious stones (other than formed to be used for mechanical or industrial purposes).
7111-2-----	Gold and gold alloys, waste.
7301-1-----	Charcoal pig iron.
7315-1-(3)-----	Alloy tool steel, free cutting steel, and alloy hollow steel.
7801-----	Lumps of lead; lead wasdfdate and scrap.
7803-----	Plates, sheets, and strip, of lead.
7805-----	Tubes, pipes, and hollow bars of lead and joints, elbows, and other tube and pipe fittings, of lead.
7901-1-----	Lumps of zinc.
7901-2-----	Zinc waste and scrap.
7903-1-----	Plates, sheets, and strip, of zinc.
7903-2-----	Zinc foil (excluding foil for stamp), zinc powders.
8103-1-----	Lumps, powders, and flakes, of tantalum.
8103-3-----	Tantalum and articles thereof, other.
8104-1-----	Uranium and articles thereof.
8104-2-(3)-----	Alloyed torium.
8104-3-----	Articles of torium.
8207-----	Tool-tips and plates, sticks, and the like for tool-tips, unmounted, of sintered metal carbides (for example, carbides of tungsten, molybdenum, or vanadium).

Quantitative restrictions on imports—Continued

JAPAN—Continued

<i>Tariff No.</i>	
8401-1-(1)-----	Steam and other vapor-generating boilers, with a generating capacity of over 650 tons but less than 1,100 tons per hour.
8401-1-(2)-----	Steam and other vapor generating boilers, other.
8405-1-(1)-A-----	Turbines with a rating (total rating in case of cross-compound type) of over 200,000 kilowatts but not less than 360,000 kilowatts.
8405-1-(1)-B-----	Turbines, other.
8406-1-(1)-----	Internal combustion piston engine for motor vehicles (excluding automobiles or 3-wheeled motor vehicles).
8406-1-(3)-----	Outboard motors with an engine not over 25 horsepower.
8406-1-(4)-----	Water cooling diesel engines with a rating more than 30 horsepower but not more than 3,000 horsepower.
8406-2-----	Parts of internal combustion piston engines (pistons, connecting rods, and cylinder blocks).
8408-1-(1)-----	Engines and motors for aircraft.
8408-2-(1)-----	Parts of engines and motors for aircraft.
8435-1-----	Automatic printing machines of the relief and lithographic, sheet-fed type.
8441-1-(2)-----	Sewing machines, other (excluding straight-line, rock-stitch industrial sewing machine more than \$40 per price in cost, insurance, and freight value).
8445-1-(1)-B-----	Automatic copying lathes, with a swing over bed less than 600 millimeters (only if more than 1 year has elapsed since manufactured).
8445-1-(1)-C-----	Automatic lathes, single spindle, of bar type (only if more than 1 year has elapsed since manufactured).
8445-1-(2)-B-----	Vertical jig boring machines (only if more than 1 year has elapsed since manufactured).
8445-1-(2)-C-----	Other drilling machines and boring machines (only the following machines): Radial drilling machines; other horizontal boring machines; other drilling machines and boring machines if more than 1 year has elapsed since manufactured (excluding the above machines).
8445-1-(3)-A-----	Universal tool milling machine (only if more than 1 year has elapsed since manufactured).
8445-1-(3)-B-----	Profile milling machines (including diesinking machines) equipped with 1 or 2 milling spindles, of a working surface less than 1 square meter, excluding hand operated type machines and cam-type machines (only if more than 1 year has elapsed since manufactured).
8445-1-(3)-C-----	Plano-millers, with a table not more than 2,000 millimeters in width, more than 1 year after date of manufacture.
8445-1-(4)-B-----	Planers other.
8445-1-(5)-A-----	Internal grinding machines with the maximum working diameter less than 200 millimeters (excluding centerless type), if more than 1 year has elapsed since manufactured.
8445-1-(5)-B-----	Surface grinding machines, rectangular table-type, with the maximum grinding length less than 2,000 millimeters, and vertical surface grinding machines, rotary table-type.
8445-1-(6)-A-----	Vertical hobbing machines, single spindle, with a table not less than 700 millimeters in diameter (only if more than 1 year has elapsed since manufactured).
8445-1-(7)-A-----	Broaching machines with a broaching capacity less than 30 weighing tons, which more than 1 year have elapsed since manufactured.
8445-1-(7)-B-----	Honing machines for bore, which more than 1 year has elapsed since manufactured.
8445-1-(7)-C-----	Machine tools, other, which more than 1 year has elapsed since manufactured.

*Quantitative restrictions on imports—Continued***JAPAN—Continued**

<i>Tariff No.</i>	
8445-2-(2)-----	Mechanical press with a nominal capacity more than 200 tons for metal or metal powder working hydraulic press with a nominal capacity more than 50 tons for metal-working.
8451-1-----	Typewriters, western type.
8452-1-(1)-----	Digital-type computer proper; and input devices, input-output devices or memory devices worked in electrical connection with the computer proper above; magnetic tape connectors or magnetic tape printers; controllers belonging to those machines.
8455-----	Parts and accessories (other than covers, carrying cases, and the like) suitable for use solely or principally with machines of a kind falling within heading No. 8452 (for digital computer).
8459-6-----	Nuclear reactors and parts thereof.
8463-2-----	Crank shafts, and clutches hydraulic type, or having reduction or reversing machine; marine reduction gear and reversing gear; parts thereof.
8501-1-(1)-----	Electric generator with a rating (total rating in case of generators used for cross compound-type system turbines) of more than 200,000 kilowatts but less than 360,000 kilowatts or generators, combined with water cooling diesel engine more than 30 horsepower.
8501-1-(2)-----	Electric generators, other.
8515-2-----	Color television receivers.
8515-3-----	Radar apparatus (for aircraft).
8515-4-----	Radio navigational aid apparatus (for aircraft); radio remote control apparatus (for aircraft).
8701-2-----	Tractors (other than wheel type).
8702-1-----	Motor vehicles for the transport of persons (including sports motor vehicles, passenger jeeps, and combined passenger-cargo cars, but not including buses falling within heading No. 8702-2, special transport vehicles such as ambulances and motor vehicles of track-laying type) (excluding autotricycles for the transport of persons).
8702-4-(3)-----	Chassis fitted with an engine and cab (those for the transport of persons).
8704-----	Chassis fitted with engines, for the motor vehicles falling within headings Nos. 8701 or 8702.
8706-1-----	Chassis for the tractors of track-laying type.
8706-2-----	Parts and accessories for the tractors of track-laying type, other.
8708-----	Tanks and other armored fighting vehicles, motorized, whether or not fitted with weapons, and parts of such vehicles.
8801-----	Balloons and airships.
8802-----	Aircrafts (other than those of heading No. 8801) and rotochutes.
8803-----	Parts of good falling in heading No. 8801 or 8802.
8804-----	Parachutes and parts thereof and accessories.
8805-----	Catapults and similar aircraft launching gear; ground flying trainers; parts of any of the foregoing articles.
9028-2-----	Instruments and apparatus for radiation containing nuclear fuels materials.
9301-----	Swords, cutlasses, and other sidearms and parts thereof.
9302-----	Revolvers and pistols, being firearms.
9303-----	Artillery weapons, machineguns, submachineguns, and other military firearms and projectors.

Quantitative restrictions on imports—Continued

<i>Tariff No.</i>	JAPAN—Continued
9304.....	Firearms, including hunting guns, very light pistols, and revolvers for firing blank ammunition only, line throwing guns and harpoon guns (not elsewhere specified or included).
9305.....	Arms of other descriptions, including air, spring, and similar pistols, rifles, and guns, truncheons for police (not elsewhere specified or included).
9306.....	Parts of arms, including roughly sawn gunstock blocks and gun barrel blanks, but not including parts falling within heading No. 9301.
9307.....	Bombs, grenades, torpedoes, mines, guided weapons and missiles, and similar munitions of war, and parts thereof; ammunition and parts thereof, including cartridge wads; lead shot prepared for ammunition.
NETHERLANDS	
0102 A II.....	Live cattle excluding breeding stock and oxen.
0201 A, 0201 B.....	Meat and edible slaughtering offals of horses and cattle, fresh or chilled.
0301 A II.....	Fel fresh (live or dead) chilled or frozen.
0301 P, 0301 C.....	Sea fish and livers, spawn and milt thereof with the exception of smelt and sprat, fresh (live or dead) chilled or frozen.
0302 A, 0302 B, 0302 C.....	Herring and liver, spawn and milt, only salted, cured, dried, or smoked other than in airtight containers, in tins or in pots.
0303 A II a.....	Shrimps or prawns in the shell, fresh (live or dead), chilled, frozen, dried, salted, cured, or simply boiled in water.
05.04.....	Poultry stomachs.
1001.....	Wheat and mixed grain with the exception of wheat and mixed grain for seeding purposes.
1101 A I b.....	Flour of wheat with the exception of self-rising baking flour.
1101 A II.....	Flour of spelt.
1101 B.....	Flour of mixed grains.
1102 A I.....	Croats, middlings, semolina, and other rolled, pearled, broken, or crushed (flakes included) of wheat.
1204 A.....	Sugarbeets also when cut, fresh, dried or in power form.
1205.....	Chicory roots, fresh or dried, also when cut, not roasted.
1206.....	Hop (cones and lupuline).
15.03.....	Lard stearine, not emulsified, not mixed, and not prepared in any way.
1507 B.....	Castor oil fluid or solid, crude, purified, or refined.
1508.....	Dehydrated castor oil.
1510 A.....	Stearic acid (stearing).
1510 B.....	Oleic acid (oleine).
1510 C.....	Other industrial fatty acids, not including fatty acids derived from tall oil.
1605 A.....	Shrimps merely boiled, peeled, and shelled, not otherwise preserved.
2914 A.....	Palmitic, stearic, capric acid and higher saturated fatty acids found in natural fatty substances also when obtained by chemical synthesis or in any other way.
2701.....	Coal, briquettes, ovoids and similar solid fuels manufactured from coal.
2944 A.....	Penicillin.
3003 A IIa, 3003 B IIa.....	Medical preparations containing penicillin.
3102 B.....	Mineral or chemical nitrogenous fertilizers with the exception of natural sodium nitrate.

Quantitative restrictions on imports—Continued

SWEDEN

<i>Tariff No.</i>	
02.03.....	Poultry liver,
02.06.....	Pork, salted, dried, or smoked.
04.02.....	Milk and cream, preserved, concentrated, or sweetened.
04.03.....	Butter, fresh.
04.04.....	Cheese.
04.05.....	Eggs not in shell, egg yolks.
08.06.....	Apples, fresh.
08.06.....	Pears, fresh.
11.08.....	Starches.
15.13.....	Margarine.
16.01.....	Sausage.
16.02.....	Pork and poultry meat, reserved or prepared, preserved pork and beans, in airtight containers.

UNITED KINGDOM

Coal, coke, and solid fuels manufactured from coal or coke.
Apples and pears, fresh; apples and mixtures of fruit containing apple, bottled or canned.

Whole hams, other than hams preserved in airtight containers.

Milk and milk products, the following: Milk (including buttermilk, skim milk and whey), fresh, frozen, evaporated, condensed, dried, or otherwise preserved; animal feeding stuffs containing more than 80 percent by weight of milk solids.

Watches and parts thereof, other than the following: Watches and watch movements of a value exceeding £5 each. Those constructed solely from parts manufactured and assembled in the scheduled territories. Watch glasses, including those of synthetic material.

Aeroplanes of an all-up weight of over 4,500 pounds.

Rum.

Grapefruit, canned.

Grapefruit, fresh.

Grapefruit juice and orange juice.

Pigmeat (other than offals) and preparations containing pigmeat other than animal feeding stuffs, canned baked beans, lima beans, and smoked ham, sausages (except fresh chilled or frozen) and soups.

Cigars.

Butter.

EL SALVADOR

Burnt sugar.

Burnt malt extract, or caramel coloring for the manufacture of beer.

Strong liquors and essences for making liquor.

Machinery for distilleries.

Cotton, ginned or not, for industrial use.

Jute sacks and containers.

Vignettes.

Labels for domestic and foreign goods.

Coffee seeds and plants.

Skins and leathers.

Firearms and accessories.

Ammunition.

Gunpowder.

Gas masks.

Certain dangerous chemical products.

Fertilizer.

Insecticides.

Parasiticides.

Fungicides.

Herbicides.

Quantitative restrictions on imports—Continued

GUATEMALA

Wheat.
 Maps.
 Explosives.
 Poultry.
 Wheat flour.
 Sacks.
 Irregulars, seconds and thirds on men's, women's, and children's hosiery.
 Fireworks.
 Gambling equipment.
 Lead alloys.
 Scrap.
 Soft wheat.
 Soft wheat flour.

IRELAND

Boots and shoes.
 Brushes.
 Electric filament lamps.
 Felt hats, etc., women's and girls'.
 Hose, silk, and artificial silk.
 Motor vehicles, chassis, bodies, body shells, body balloons.
 Screws, tapered thread.
 Sparking plugs and metal component parts.
 Springs (laminated) and leaves thereof, for vehicles.
 Superphosphates.
 Tires and tubes.
 Wearing apparel of woven tissue, rubberproofed, completely or partially manufactured articles and component parts, rubberproofed.
 Woven piece goods containing more than 60 percent by weight of cotton.
 Woven piece goods (other than floor coverings) made wholly or partly of wool or worsted; certain woven piece goods made wholly or partly of synthetic or artificial textile.
 Apples, raw during control periods, except under license issued by the Minister for Agriculture.
 Bacon (i.e., the carcass of a pig or any part (excluding the head, feet, rind, or offals) of the carcass of a pig which has been salted, pickled, or otherwise cured, and including ham and gammons).
 Butter.
 Cereals, cereal products, etc.
 Feeding stuffs.
 Cheese.
 Fish (which are either fresh or frozen, but not including shellfish).
 Fruit of any of the following descriptions preserved in water, without the addition of sugar or other sweetening matter, viz., apples, pears, plums (including damsons), prunes, and greengages, cherries, strawberries, raspberries (including loganberries), currants and gooseberries, or any pulp or juice wholly or partly derived from such fruits.
 Meat of any bovine animal or sheep, fresh, frozen or chilled.
 Milk, dried or powdered (including dried or powdered milk which has been treated by way of processing or the addition of any other substance).
 Onions, raw, whether fresh or dried, during certain control periods.
 Pigs, live.
 Seed, grass.
 Seeds of any of the following descriptions: Sugarbeet, fodder beet, kale (including hungry gap kale, marrow stem kale and thousand headed kale), mangel (including sugar mangel), rape and turnip (including swede turnip).
 Sugar, except under license issued by the Minister of Agriculture.
 Tobacco, whether manufactured or unmanufactured.
 Tobacco seeds and plants.
 Tomatoes, raw, during certain control periods.

Quantitative restrictions on imports—Continued

MEXICO

Leather shoes.
Whisky.
Cigarettes.
Unassembled vehicles.
Alcoholic beverages.
Raw materials, such as hides and skins.
Chemical woodpulp.
Jute fiber.
Artificial vegetable fiber.
Plastic fibers.
Wood.
Sulfur.
Salt.
Rerolling material.
Tin scrap.
Gums.
Chicle.
Lubricating oils.
Gasoline.
Paraffin.
Animal fats and oils and most vegetable oils.
Numerous inorganic chemicals, some organic and organometallic chemical products.
Prepared paints and varnishes.
Perfumery products.
Soaps and detergents.
Chemical fertilizers.
Explosives, explosive caps and fuses.
Synthetic resins.
Household disinfectants, deodorants, and fumigants.
Insecticides and fungicides.
Brake fluid.
Additives for lubricating oils.
Miscellaneous mixtures and preparations for industrial use.
Leather.
Various plastic sheets and tubes.
Toys and dolls of all kinds.
Wooden doors, windows and moldings.
Some paper and cardboard products.
Zippers.
Some yarns and many fabrics.
Portland cement.
Tiles.
Clay and gypsum manufactures.
Sandpaper.
Glass tubes, rods, containers, and miscellaneous glass manufactures.
Precious and semiprecious stones.
Jewelry.
Iron and steel ingots, bars, wire pipe and fittings.
Nails, rivets, hooks, and hinges.
Tin ingots, tinplate, and containers thereof.
Steel wool.
Cooper bars, wire, pipe, sheets.
Steel, copper, and aluminum screening.
Locks.
Door closers.
Casters.
Some machinery.
Stationary motors.
Electric motors, stators and rotors.
Concrete mixers.
Pumps.

*Quantitative restrictions on imports—Continued***MEXICO—Continued**

Household appliances, such as sewing and washing machines, mixers, stoves, toasters, heaters, refrigerators, irons, radios, and television sets.
 Filters.
 Hammers.
 Wrenches.
 Transformers.
 Light bulbs.
 Electrical wire and cable.
 Switches and switchgear.
 Some parts for machinery, apparatus, and appliances.
 Automobiles, trucks, buses, and chassis, assembled or unassembled, motorcycles, motorbikes, motorscooters and bicycles and most parts.
 Wearing apparel and haberdashery.
 Leather footwear.
 Household linens and furnishings.
 Wooden and metal furniture.
 Luggage and travel goods.
 Handbags, briefcases, and wallets.
 Sanitary ware.
 Hypodermic needles and syringes.
 Automatic meters for liquids and gases.
 Eyeglass frames.
 Watches, cases, and bands.
 Pencils.
 Ballpoint and automatic pencils, ballpoint and fountain pens, and parts.
 Vending machines.
 Silver tableware.
 Firearms, parts, and ammunition.
 Matches.

PANAMA

Salt.
 Evaporated milk, condensed milk.
 Whole tomatoes, tomato paste, tomato sauce with meat, tomato sauce with mushrooms.
 Ketchup, hot sauce (for the table).
 Tomato soup, tomato juice.
 Soy sauce.
 Dehydrated tomatoes.
 Rice in any form.
 Nontropical fruit juices.
 Cotton plus.
 Hard candy, stuffed candy.
 Cream from milk, cheese made with skimmed milk.
 Vienna-type sausages.
 Prepared mustard.
 Canned kidney beans.
 Plastic glasses.
 Sanitary pads.
 Steel rods and bars.
 Mentholatum and Mentholatum ointment, Vicks Vaporub.
 Listerine.
 Lavioris.
 Astringosol.
 Vicks.
 Penetrate and similar products.
 Hatching eggs.
 Marmalade, jellies.
 Tropical juices.
 Wire screens and its substitutes.
 Lather of polyuria and its substitutes.
 Detergents and powder for washing.
 Mayonnaise, mayonnaise with cucumber, salad dressing.
 Edible fats and oils.

Quantitative restrictions on imports—Continued

PANAMA—Continued

Lard substitutes, vegetable lard.
Oleomargarine.
Flour.
Tin cans.
Potatoes.
Chewing gum.
Paper bags with multiple walls.
Matches.

