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RFD 293

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 5, 1957

Geoffrey Crowther on the "Dollar Shortage" 8 pages

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NOT FOR PUBLICATION

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Geoffrey Crowther on the "Dollar Shortage"

The recent balance of payments difficulties of the United Kingdom, which started in 1956 in connection with the Suez crisis, have produced a new crop of papers on the "dollar shortage". Sir Geoffrey Crowther who takes pride in having discovered the dollar shortage 20 years ago, has reiterated his creed in three lectures, which he delivered at Harvard University in April 1957 and which are now available in print.1/

Sir Geoffrey's theses

In his first lecture on "The Nation's Pattern of Growth" Sir Geoffrey expounds the Kindleberger theory of long-term balance-of-payment cycles,2/ whereby a country progresses from an "immature debtor" to a "mature creditor" position. Curiously enough, Sir Geoffrey never mentions Kindleberger's authorship of this theory, although he specifically lauds Kindleberger for having acknowledged Sir Geoffrey's priority in the question of the dollar shortage (page 34). Sir Geoffrey tries to apply the Kindleberger theory to all trading nations for 1937, 1949-51, and 1952-54, with rather curious results. In 1937 and in 1949-51, the United States, together with Sweden, appears as an "immature creditor" while such countries as Netherlands and the United Kingdom are classified in both instances as "mature creditors". In 1952-54, the United States finally advances to the "mature creditor" class while the three other countries have become "immature creditors" and been joined in this grou~ by such unlikely countries as Portugal and Austria. It is not quite clear how all this is connected with the other lectures; the only conclusion that can be drawn is that the Kindleberger theory cannot explain short-run changes in balance-of-payments positions--which it was not meant to do in the first place.

In the second lecture entitled "One World? or Two? or Twenty?" Sir Geoffrey discusses the main monetary areas of the free world, namely the dollar area, the sterling area, and the EPU area, the last two of which are inter-connected by the United Kingdom's being a member of both. Within each area, there is rather extensive freedom of payments, at least on current account, while there are still substantial restrictions on payments from the sterling and EPU areas to the dollar area. This fact is important for United States entrepreneurs, who have to decide whether to capture markets in the EPU and sterling areas through direct export or through establishment of foreign subsidiaries. Sir Geoffrey cites the example of his own fountain pen, which was manufactured in Australia from American parts and American designs, and which can be sold freely in the United Kingdom and in Western Europe, while its direct importation from the United States would be restricted in most of these areas (page 33); he does not state whether he believes in the wisdom of a system that permits an American pen to be sold in Europe only if it is shipped through, and assembled in Australia.

1/ Geoffrey Crowther, Balances and Imbalances of Payments (1957).
2/ Charles P. Kindleberger, The Dollar Shortage, Chapter 6 (1950).

Sir Geoffrey expresses the opinion that convertibility will be maintained within the Eastern Hemisphere, including in particular in the sterling and EPU areas, but will not be achieved between the Eastern Hemisphere and the dollar area. The reasons for his scepticism is the belief that the classical adjustment procedures through exchange rate variations and monetary and fiscal policies, which work well enough if the disequilibria requiring adjustment are moderate, cannot work if these disequilibria are very extensive, since the necessary radical adjustments of exchange rates or wages and prices would meet insuperable political resistance.

In his third lecture on "The Scarce Dollar" Sir Geoffrey finally explains why in his opinion the disequilibria between the dollar area and the Eastern Hemisphere are so much greater than those among the various countries within the Eastern Hemisphere. The first reason is the "enormous relative economic strength of the United States . . . a position of relative strength without any parallel in economic history" (page 45). This strength is due in part to "the economies of mass production for the enormous domestic market . . . the archetype of this is the American automobile" and in part the advanced American technology: "in industry after industry, it is not simply that the American machine is better or cheaper, it is the only one obtainable that will do the job." Sir Geoffrey quotes two examples, high speed printing machines and heavy highway construction machines (page 46). "All these things make it very difficult for other countries to keep up and hopeless for them to catch up" (page 47).

The second reason is that the demand of the Eastern Hemisphere for United States products is "urgent and swelling" (page 46) while in contrast "the demand of the United States for the products of the Eastern Hemisphere is neither very elastic nor very urgent" (page 47). The Paley report does not contradict this statement because it is only a "charter of economic hope" for the other countries of the dollar area, not for the raw material producers in the Eastern Hemisphere.

The balance of payments of the United States does not reveal the full extent of the disequilibrium because of the persistence of discriminatory restrictions on American goods; in their absence the export surplus of the United States "would be in excess of $10 billion a year and might be much more." While eventually the situation might well adjust itself, such an adjustment "is going to take a very long time" (page 49).

In view of the magnitude of the disequilibrium, Sir Geoffrey doubts, moreover, the effectiveness of even drastic actions of adjustment by classical methods, such as a devaluation of the pound sterling from $2.80 to $1.40 (page 50). He has no hope that an adjustment would come about by a more rapid rise in American internal costs and prices, as Lord Keynes had expected; the cost level in the United States "relatively to the level in other countries, has been falling rather than rising." Relatively small changes in costs and prices would be useless, "for there are so many American goods that the world wants whatever they cost" (page 51). A more liberal trade policy of the United States would not close the gap because the United States trade restrictions, while unnecessarily complicating the dollar problem, are of minor importance (page 52). Neither does Sir Geoffrey expect a flow of economic aid or of private capital large enough to close the gap (pages 53 and 54).

Sir Geoffrey concludes therefore that there will be no removal of import controls and of discrimination against American goods "in our lifetime" (pages 59 and 60). However, while the situation is "regrettable," it is not an "unmitigated disaster". The fact "that it is Two Worlds and not twenty or eighty means that there is still plenty of scope for the division of labor and for the healthy astringent force of competition" (page 60). Moreover, "we are already learning to live with our Two-World system" (page 61).

Comments

East and West -- Sir Geoffrey is guilty of an unjustified use of aggregates. In particular, it is doubtful whether it is meaningful to treat the "Eastern Hemisphere" as an economic unit. Germany's balance-of-payments surplus vis-à-vis the rest of the "Eastern Hemisphere" is much greater than Germany's deficit vis-à-vis the United States; if Sir Geoffrey expects the rest of the "Eastern Hemisphere" to live with Germany without controls and discrimination, it seems inconsistent for him not to expect Germany to live so with the United States.

The U. S. export surplus -- More important however, is Sir Geoffrey's faulty evaluation of the alleged disequilibrium between the United States and the rest of the world. His choice of the automobile as the typical product of the American mass market is somewhat unfortunate from the point of view of his argument; in 1956 the United States exported to Western Europe $118 million of automobiles, but imported from Western Europe $141 million, and European cars have for some time outcompeted American makes in many countries that do not discriminate against United States products (e.g., Switzerland). This development indicates that it has not been "hopeless" for Western Europe to "catch up" with the United States in this field.

It may well be that American machinery is superior to other types in the case of high speed printing and heavy highway construction. On the other hand, there are several fields in which Western European machinery is superior, and we have recently seen that there are important engineering sectors in which Soviet technology seems to be superior to both. It is true that the United States has continually had an export surplus in the field of machinery and vehicles; in 1956, the U. S. export surplus in this category alone ($4.5 billion), was substnatially larger than the total export surplus ($4.1 billion). Nevertheless, in relation between the United States and Western Europe the export surplus in the field of machinery and vehicles ($336 million) represented only 15 per cent of the total export surplus ($2.2 billion). The major part of the total export surplus was accounted for by foodstuffs, inedible animal and vegetable products, and textile fibers; the export surplus in these categories amounted to $1.6 billion, or about three-fourths of the total export surplus (see Table 1). In the field of these foodstuffs and other agricultural products, however, the United States has to compete fiercely with other suppliers in a buyer's market, and in order to maintain its exports has to resort to policies that frequently border on the making of sheer presents to the "purchasers". There is no reason to assume that European demand for these goods is particularly "urgent and swelling". Actually, that part of the world which has really an "urgent and swelling" demand for American machinery and vehicles is the rest of the Western Hemisphere; in 1956, the United States export surplus in these items to the rest of the Western Hemisphere exceeded $3 billion. The Western Hemisphere, however, is the only part of the free world which according to Sir Geoffrey himself has no reason to fear a secular dollar shortage.

Elasticities of import demand -- In discussing demand elasticities, Sir Geoffrey permits himself a slight equivocation: while he mentions only the elasticities of the Eastern Hemisphere demand for United States goods and of the United States demand for Eastern Hemisphere goods, his remarks about the rest of the Western Hemisphere indicate that he is interested in the balance of payments of the Eastern Hemisphere with the entire Western Hemisphere rather than with the United States alone. Even if the Eastern Hemisphere could not balance its payments with the United States alone, it still might balance its payments with the entire Western Hemisphere: after all, the rest of the Western Hemisphere (whose imports in 1956 were larger than those of the United States) has never been accused of being in the "unique" situation of economic strength and perverse demand elasticities in which the United States, according to Sir Geoffrey, finds itself.

However, the very idea of a "unique" configuration of demand elasticities is at variance with the development of the terms of trade of the United States. If Sir Geoffrey were correct, the terms of trade of the United States should tend to improve. Actually, the United States has suffered a worse deterioration in its terms of trade, both as compared with 1937 and 1948, than any other major trading nation or trading area; in 1956, its terms of trade were 25 per cent less favorable than in 1937 and 15 per cent so than in 1948; in the same period the terms of trade of Canada and Western Europe remained about unchanged, those of Latin America and the outer sterling area improved significantly, and those of the United Kingdom deteriorated by only 12 and 6 per cent, respectively.

Sir Geoffrey also exaggerates the consequences of lifting discriminatory import restrictions against the United States; according to the experience of all countries which have had the courage to take such steps (such as Belgium, Germany, the Netherlands, and Sweden), the effect on the country's total balance of dollar payments is small. In the field of machinery, on which Sir Geoffrey lays such stress, such restrictions have already been virtually eliminated by most industrial countries. Moreover, the process of relaxing discrimination against dollar goods has gone on steadily since the end of the war, without preventing the "Eastern Hemisphere" from adding substantially to its gold and dollar holdings in every year from 1952 through 1956.

Regional aspects of "dollar shortage" -- Finally, Sir Geoffrey overlooks the implications of the regional composition of the balance of payments of the United States (see Table 2). It is not the "Eastern Hemisphere" as a whole, but a very small and distinct part of that hemisphere, that has tended to rely on United States government loans and grants to meet a significant part of its dollar needs. The year 1956 was not particularly good from the point of view of the dollar balance of the "Eastern Hemisphere": in most industrial countries economic expansion proceeded faster than in the United States, tending to increase their trade deficits; several nations experienced serious inflationary pressure; and toward the end of the year the trade and payments relations of Europe and the Near East were aggravated by the Suez crisis. Nevertheless, in 1956, as in all previous years since 1952, the United States transferred to the rest of the world more than $1 billion in gold and dollars (including U. S. government and corporate securities). In relation to Western Europe, a "civilian" current account surplus was nearly offset by U. S. military expenditures; the net flow of private capital -- including inter-regional settlements[1] and speculative movements recorded under "errors and omissions" -- turned the balance in favor of Western Europe, and this balance was greatly increased by the net flow of government loans and grants. If the overseas dependencies of Western Europe as well as the independent members of the outer sterling area -- which comprise the "Eastern" area of relative freedom on which Sir Geoffrey's analysis is based -- are considered together, the "civilian" current account surplus in favor of the United States was nearly offset by the sum of military expenditures and the net flow of private capital, and was turned into a large balance in favor of the "East" by the net flow of government loans and grants.

In relation to Canada and Latin America a "civilian" current account surplus of the United States was more than offset by the net flow of private capital alone; the resulting balance in favor of the rest of the Western Hemisphere was further increased by military expenditures and the net flow of government loans and grants. Only with the "rest of the world" -- including primarily the non-sterling countries of the Near and the Far East -- was the "civilian" current account surplus of the United States not offset by military expenditures and the net flow of private capital; in fact, the net flow of private capital from this region showed a "perverse" tendency to increase the surplus of the United States, and the net flow of government loans and grants was needed to reduce the region's dollar losses to manageable proportions. The "rest of the world" accounts for 14 per cent of the international flow of United States goods and services; however, although a further breakdown of the United States balance of payments is not available, it seems probable that the disequilibrium in that area is attributable mainly to a few underdeveloped countries, which receive a very small part of all United States exports of goods and services but a very large part of all United States aid, while the position of the most important single member of the group, Japan, is more like that of the industrial countries of Western Europe.

Conclusions

This analysis permits the following generalizations: First, not only the Western Hemisphere but also Western Europe, regardless of whether taken by itself or whether considered together with its overseas dependencies

1/ The problem of inter-regional settlements, which involves the basic question of whether a country's "dollar shortage" is related to its balance of dollar payments or rather to its total balance of international payments regardless of currency, will be discussed in a separate paper.

and the independent members of the outer sterling area, can balance their accounts with the United States, even under rather unfavorable world conditions, while relaxing restrictions on dollar imports and without relying on United States aid, as long as the United States maintains its flows of military expenditures and private capital. Second, the underdeveloped countries of the rest of the world -- which, however, account for a very small fraction of the international flow of United States goods and services -- can probably maintain such a balance with the United States only as long as the United States provides aid in the form of government loans and grants.

Only these countries may thus be considered to be in danger of a "dollar shortage". The reason for this shortage is not the technical superiority of the United States over other industrial countries or the perversity of demand elasticities, but mainly the tendency of some of these countries to engage in development and other programs exceeding their domestic resources, without at the same time establishing the conditions necessary to permit a sufficient inflow of private foreign capital. While this situation presents difficult questions for American foreign economic policy, it has little if anything to do with the problems discussed by Sir Geoffrey.

Table 1

U. S. Trade Balance, 1956

(In millions of dollars)

	All Areas	Canada and Latin America	Western Europe 1/	Rest of World
Food	- 788	-1,585	+ 708	+ 89
Inedible animal and vegetable products	+ 199	+ 66	+ 510	- 377
Textile fibers and manufactures	+ 349	+ 218	+ 192	- 61
Wood and paper	-1,144	-1,065	- 57	- 22
Non-metal minerals	- 235	- 215	+ 383	- 403
Metals and manufactures	- 343	- 177	- 28	- 138
Machinery and vehicles	+4,525	+3,027	+ 336	+1,162
Chemicals	+ 961	+ 525	+ 174	+ 262
Miscellaneous	+ 570	+ 382	- 62	+ 250
Total 2/	+4,094	+1,176	+2,156	+ 762

1/ Excluding Greece and Turkey.

2/ Excluding "special category" exports for which no regional breakdown is available.

Source: U. S. Department of Commerce, World Trade Information Service, Part 3, No. 57-9.

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Table 2

U. S. Balance of Payments, 1956

(In millions of dollars)

	All Areas	Canada and Latin America	Western Europe Excluding Dependencies and Outer Sterling Area	Western Europe Including Dependencies and Outer Sterling Area	Rest of World 1/
Goods	+4,530	+1,256	+2,397	+2,409	+ 865
Services (including pensions and remittances)	- 589	+ 34	- 575	- 569	- 54
Capital income	+2,040	+1,245	+ 55	+ 375	+ 420
Military expenditures	-2,910	- 286	-1,676	-1,859	- 765
Private capital (including inter-area transfers and errors and omissions)	-1,881	-2,887	- 411	- 265	+1,271
Government capital (including grants)	-2,321	- 173	- 524	- 868	-1,280
Total 2/	-1,131	- 811	- 734	- 777	+ 457

1/ Excluding Western European dependencies and outer sterling area.

2/ Transfer of gold, dollar balances, and U. S. government and corporate securities.

Source: U. S. Department of Commerce, Survey of Current Business, March and June 1957.

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