OUR BALANCE OF PAYMENTS

The 'Conspiracy of Silence'

by Benjamin Graham

THE PROBLEM, in relation to our balance of payments, is a highly paradoxical one. On the one hand there has been a real threat in the international position of the dollar; on the other, this threat arose from reasons which are in no sense basic and which differ completely from the standard causes of foreign-exchange difficulties.

In this paper I shall refer to more recent developments, and inquire further into a question which I have found most intriguing: Why have the innumerable commentators on the problem—from President Kennedy at one end of the spectrum to U. S. Steel's Robert Tyson at the other—failed to mention (except in completely inadequate fashion) the underlying cause of our "dollar crisis?" It is this virtually unanimous ignoring of the most important fact in the case that has invited the phrase "conspiracy of silence" used in our title.

This paper will be written in an uncompromising style and will be highly critical of other people's statements. It will surely hurt the feelings of some and will strike many as intemperate and even arrogant. My excuse (for what it is worth) is that the strength of the dollar, a primary interest of the United States, may well depend on a proper understanding of a much misunderstood situation. To bring that about, a forthright utterance may be essential.

RISE AND "DISAPPEARANCE" OF THE DOLLAR CRISIS

Our balance-of-payments problem began in 1958. In 1951-57 we had experienced an overall adverse balance averaging about $1 billion a year. This was regarded as a favorable development for international stability, since it permitted other nations to acquire gold and dollars to build up their sorely needed monetary reserves. But in the next three years our adverse balance averaged $3.7 billion, and in 1961 it was about $2.5 billion. This four-year loss of some $13½ billion in international "liquidity" transformed our net position from a credit balance of $6.7 billion to a debit balance of about the same amount (*Table I*). It became evident that we could not long continue a liquidity drain at this rate and maintain the international value of the dollar. Hence the "dollar crisis," and the widespread view that it would soon have to be devalued in terms of gold.

Our government steadfastly denied any such necessity or intention. It stated its expectation that various steps would place our foreign accounts in balance by the end of 1963. Figures for the second quarter of this year showed improvement—the adverse balance falling to an annual rate under $1 billion; and the anticipated deficit for 1962 was placed at about $1½ billion.

At the September convention of the World Bank and the IMF in Washington, central bankers from many countries "hailed the end of the dollar crisis" and "dismissed devaluation" as no longer a threat. In fact, they began to express worry at what would happen to their own trade balances and international liquidity when our own deficits had ceased. (Whether our balance-of-payments problem is indeed under full control is a separate question, to be dealt with later).

An observer might well suspect that the threat to the dollar could not have been a fundamental one if it could be dispelled by a change in the figures of a single quarter together with some reassuring official statements. This brings us to our thesis: The loss of liquidity by the United States since 1957 can be traced directly and exclusively *to the increase in the annual rate of our net foreign investments.* A development of this kind is not basic to a country's foreign-exchange position; it has never compelled a devaluation in the past, and need never be permitted to bring on an unwanted devaluation in the future.

The true situation was summed up epigramatically by

Table I

U. S. Liquid Position and U. S. Equity Position 1949-1961
(in billions)

	Dec. 1949	Dec. 1957	Dec. 1961*
Gold	$24.6	$22.8	$16.9
Less Due Foreigners on Short-term	7.0	16.1	23.8
Primary Liquidity	17.6	6.7	def. 6.9
Add:			
U. S. Private Investment			
Short-term (gross)	1.3	3.2	6.0
Long-term (net)	8.4	20.8	30.2
U. S. (Private) Equity	27.3	30.7	29.3
Add:			
U. S. Government Advances	11.0	17.3	17.0
Total Equity	38.3	48.2	17.0

*Partly estimated from balance-of-payments figures.

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Table II

Our Balance of Payments in Long-Term Perspective
(Annual averages in millions)

Period	Group A All Private Accounts (Excl. Capital)	Group B All Gov't Accounts (Incl. Capital)	A + B Current Balance (Equity Change)	Group C Private Investment (Net)*	A + B + C Final Balance (Change in Liquidity)
	cr	dr			
1929-41	$ 650	$ 100	cr $ 550	cr $ 570	cr $1,120
1942-45	....	....	dr 1,530	dr 170	dr 1,700
1946-49	7,942	5,928	cr 2,020	dr 100	cr 1,920
1950-57	4,537	4,877	dr 340	dr 940	dr 1,200
1958-1961	5,016	5,326	dr 310	dr 3,130	dr 3,440

*Excl. foreign short-term investment here.

Aggregate Balances for Two Periods

	21 Years 1929-1949	12 Years 1950-1961
Current Balance (Change in Equity)	cr $ 9,100	dr $ 4,000**
Our Foreign Investments (net)	cr 6,300*	dr 20,000
Final "Balance" (Change in Liquidity)	cr $15,400	dr $24,000

*Disinvestment—i.e., excess of foreign investment here
**Our equity in unremitted earnings would exceed this debit balance.

a delegate to the recent world bankers' convention as follows: "The United States has not been living beyond its international means, but it has been investing beyond its international means."

The correctness of this diagnosis will be demonstrated by the comparative data which follow. We shall then deal with certain contentions that seek to absolve our foreign-investment rate from responsibility for the dollar crisis. Later we shall ask why the facts in the matter have been all but universally ignored. Finally we shall indicate how in our opinion the origin of our difficulty itself suggests the best way of dealing with it.

Our Balance of Payments In Longer Perspective

In *Table II* we summarize our foreign accounts for the long period 1929-1961 in a revised form intended to bring out the true significance of the figures, and in particular the extraordinary change in our foreign-investment operations in recent years as against all previous periods. The accounts are combined here into only three basic groups:

A. All private transactions, net, except private capital accounts.

B. All government transactions, net, including capital accounts.

C. Private capital accounts, net, (excluding foreign *short-term* capital) plus "unrecorded transactions (errors and omissions)."

Group A includes imports and exports, various services, transferred income from foreign investments, and our private remittances abroad. It excludes government services and "military transactions," which the official classification lists among "exports and imports of goods and services." We add these items—important since 1940—to other government receipts and payments in Group B.

The "unrecorded transactions" are included with our capital accounts, in Group C, since it is generally understood that most of these items represent transfers of capital into or out of this country which move "outside channels normally covered by our reporting network." Foreign short-term capital movements are excluded from Group C, because they are treated as a balancing item similar to gold movements. (Our own private and governmental short-term balances abroad are not considered offsets against the foreign balances here, mainly because our government cannot use them at will to meet demands on our gold.)

It is instructive to divide our foreign account developments since 1929 into five periods: (1) Pre-war—1929-41; (2) World War II—1941-45; (3) Post-war—1946-49; (4) Korea-Suez—1950-57; and (5) Dollar crisis—1958-61. Our true "balance of trade" in each period is found by combining Groups A and B, and excluding our net private capital transactions. This balance may be considered as our "net profit or loss" in dealing with the rest of the world, or as our "balance on current account," or as our "net change in foreign equity."

Here we see varying results between 1929 and 1949, followed by a very moderate average adverse balance in the past 12 years. Actually, the adverse balance disappears when our unremitted gains on investments are taken into account. Thus, our overall "equity" position has increased somewhat since 1949 and since 1957, without counting any part of our government advances, some of which are being currently collected.

The important point to note is that the small "current loss" was slightly lower in the dollar-crisis years than in the "contented period" of 1950-57. Not only that, in 1961—at the very height of the dollar scare—we were

Table III

What Is Responsible for the Change in Liquidity Balance Between 1949 and 1961?
(in millions)

	(Merchandise Balance Only)	Group A All Private Excl. Capital	Group B All Government	A + B Current Balance	Group C Private Investment, Net	A + B + C Final Balance
1949	($5,424)	cr $6,140	dr $6,270	dr $ 130	cr $ 341	cr $ 211
1961	(5,340)	cr 6,815	dr 5,327	cr 1,488	dr 3,949	dr 2,461
Change	(dr 84)	cr 675	cr 943	cr 1,618	dr 4,290	dr 2,677

reporting one of the largest favorable *current* balances in our history (exceeded only in 1946-47), even after deducting over $5 billion net of government expenditures abroad.

The chief figures to observe in *Table II* are those of our net foreign investments (Group C). From 1929 through 1949 we actually had a net *dis*-investment—excess of foreign purchases here over ours abroad—aggregating over $7 billion.

For the 1950-7 period our net private investments averaged somewhat under $1 billion.

We started that period in an extremely liquid position, with too much of the world's gold, and it was logical for us to exchange excess liquidity (earning no return) for profitable foreign long-term investments. But later our behavior resembled that of investor-speculators in our own bull market.

As our liquidity decreased—i.e., our capacity for making foreign investments without monetary strain—we stepped up enormously the *annual rate* of such investments. Excluding offsets by other investors here, our capital transfers rose from $600 million in 1949 to $1.3 billion in 1955 and then to $4.6 billion in 1961. (Unrecorded transactions of $600 million are included in the latter figure). We have indeed been investing beyond our international means.

CHALLENGES TO OUR THESIS

My emphasis on the rise in the rate of foreign investment as the basic cause of the dollar crisis has been challenged on various accounts. Consideration of these objections should help clarify the picture. The first argument is that there is no valid reason for singling out the investment item for blame, since our adverse balance is the resultant of many factors—including, on the debit side, notably our huge outlays for foreign aid and military expense abroad. One aspect of this general viewpoint was stated by one who certainly should know the subject, Walter Lederer, Chief of the Balance of Payments Division of the United States Department of Commerce. He says: "However, as long as the offsetting relationship between capital movements and changes in other transactions continues, both have to be considered in an evaluation of the balance of payments, and one cannot view some types of transactions as more 'basic' than the others."

The implication here seems to be that each year's foreign investments may have generated offsetting credit items of corresponding magnitude, and thus this category may not be usefully analyzed by itself as a causal factor in our difficulties.

But what are facts and figures? Let us look first at *Table III,* which compares the results for 1961 with those for 1949. In 1949 we had a small adverse balance on current account, but our investments abroad were then *less* than foreigners' here (treating unrecorded transactions as investments). Hence we ended 1949 with a slight increase in liquidity. In 1961 we had almost a $1½ billion favorable balance on current account, but net investments abroad of nearly $4 billion changed this figure into a very embarrassing final adverse balance of some $2½ billion.

Should the blame for this spectacular *change* be spread about indiscriminately between our trade accounts, our government expenditures and our foreign investments? Does the primary cause of the trouble defy identification? How can we ascribe the deficit to lagging exports—to "being priced out of the market," as so many have done—when our favorable merchandise balance in 1961 ($5.3 billion) was about equal to that of 1949, in spite of the trade advantages we enjoyed in the post-war years of European reconstruction?

Furthermore, our combined credit balance for goods and services (non-governmental) was actually $675 million *better* than in 1949. Yes, say some, but the real culprit is obviously our government's program of foreign aid and military support. Are these experts aware that we spent $940 million *less* for these purposes in 1961 than in 1949? By what logic can one blame an element that shows *improvement* for a great deterioration in the overall picture? Since foreign investments are the only group that shows a significant adverse change, and since this change is of extraordinary magnitude, its role as architect of our embarrassment should be obvious to anyone who looks at the figures.

Objections Cited

But, again say the objectors, these investments generate large offsetting credits, and so they do our liquidity no overall damage. Chief of these is our income therefrom. In 1961 this income received from abroad totaled $3,645 million and was not much less than the $3,951 million we added to our investments (excluding here the unrecorded transfers). It is widely held that the closeness of these items of income and outgo prove that our annual foreign investments have been responsible for

only a small part of our recent balance-of-payments deficits.

Plausible as this contention may sound, it is entirely fallacious. It fails to consider that nearly all the income from investments received in, say, 1960 and 1961, would still have been received even if we had not added a single dollar to our $45 billion of capital abroad at the end of 1959.

A reasonably accurate calculation on this point, covering 1958-1961, appears in *Table IV*. It shows that the $14 billion of private capital sent out of this country in the last four years produced at most about $1.2 billion of *additional* remitted income—an offset of less than 10% against our outlay. The entire "deficit" of 1960 and 1961—the period of maximum dollar crisis—would probably have been obviated had we reduced our gross capital outflow to, say, $1 billion each year instead of about $4.5 billion. (The current loss of investment income from this reduction would have been quite minor).

Defenders of our huge capital commitments argue further, in this context, that they produce other important balancing credits in the form of additional exports of capital goods, which presumably would not have been made had we not increased our foreign plant accounts. Hence there is no way of determining the overall effect of these outflows on our final balance of payments.

In the narrow sense of complete accuracy this is of course true. But we have some data which throw light on the approximate magnitude of the claimed offsets. (These appear in an elaborate study of "U. S. Business Investments in Foreign Countries," published in 1960 by the United States Department of Commerce). The figures indicate that our foreign interests in 1957 bought about $1 billion of capital goods from the U. S., as against a total of $4.9 billion they spent that year on plant account. Our total outflow for foreign investments in 1957 was $3.2 billion, of which $2 billion was for these "direct investment enterprises."

There is an indication from these figures that our foreign investments in any year may generate about 30% in offsetting capital exports. On the other hand, our direct investment enterprises exported over $3.7 billion of goods to this country in 1957, a figure which apparently well exceeded their total purchases of goods from us. (The "incomplete total" of the latter, as compiled by the study, was $2.6 billion). The text of the study emphasizes the dollar-saving advantages to the countries in which our investments are made. The implication is quite clear that, apart from remittances of income (already discussed), we lose rather than gain in the net effects of such investments on our balance of payments.

THE CONSPIRACY OF SILENCE

The data presented in our four tables should show clearly that the greatly enlarged rate of our investments abroad has the primary responsibility for the recent dollar crisis. Has any of my readers seen this aspect of the problem recognized, or the problem discussed in any detail, in the numerous pronouncements of the subject from nearly every authoritative source? I have not—before last September, at least. Let me now deal with the way the subject has been handled and the possible reason therefor.

Table IV

Effect of 1958-1961 Foreign Investment on Our Income from Abroad

(in millions)

Investment income as at Dec. 1957	$ 2,900
Expectable income 1958-1961 without new investments (Four times the Dec. 1957 rate)	11,600
Actual investment income 1958-1961	12,815
Gain in income as a result of 1958-1961 investments	1,215
Our capital outflow 1958-1961 (about)*	14,700
Net loss in liquidity: 1958-1961 capital outflow less gain in income	13,500

*Includes unrecorded transactions aggregating about $1,200 million net.

There has been no recognition of the essential difference between the loss of liquidity from an unfavorable trade balance and one occasioned by investments. The January 1962 discussion by the Council of Economic Advisers combines both groups of transactions into what they term the "basic accounts."

Could the plant investment made by a business be "basic" in the same sense as its profit or loss from operations? By contrast the official Canadian analyses carefully distinguish between what they call the "Current Account Balance" and the "Net Capital Movement." A comparison between the highly unfavorable current balance of Canada since 1955 and the approximately break-even results of the United States in that period would have brought home the fact that Canada was to experience a true foreign-exchange crisis, while ours could be only a superficial or artificial one.

President Kennedy, in his February 1961 Special Message on the Balance of Payments, stated: "The surplus of our exports over imports, while substantial, has not been large enough to cover our expenditures for military establishments abroad, for capital invested abroad by private American business, and for government economic assistance and loan programs."

Note that our foreign investments are *sandwiched between* military expenditures and government aid—as if they were all of essentially the same character. This burying of capital items in the middle of expense items became the general treatment—*and a most misleading one.*

In his May 1962 speech to the U. S. Chamber of Commerce the President further stated: "It costs the United States $3 billion a year to maintain our troops and our defense establishment and security commitments abroad. If the balance of trade is not sufficiently in our favor to finance this burden, we have two alternatives: one, to lose gold, as we have been doing; and two, to begin to withdraw our security commitments."

Here our foreign investments are not even mentioned. The fact is that our *balance of trade*—with investments excluded—has been sufficiently in our favor to finance virtually all our government outlays abroad.

The President, in ignoring the role of enlarged investment may be plausibly ascribed to his strong desires in two directions: first to prevent wage and price increases here; and second, to persuade our prosperous allies to assume a larger share of our overseas burdens. For one purpose it is useful to assert that our exports must be substantially increased; for the other, to imply that the dollar's position is really precarious and in need of aid from our allies.

Finance Chairman Tyson of U. S. Steel, last March, put the case in stronger language—and in my view, with even greater inaccuracy. Said he: "There is only one real solution of the problem of unfavorable balances of payment: it is the development or restoration of greater ability to compete in international markets." The purpose of that statement is clear from the next sentence: "That means, in turn, I think, that Americans must find the fortitude to bring to an end the era of flat wage inflation."

Most of us would agree that wage inflation should be halted. But some of us would disapprove basing that demand on an alleged impairment of our ability to compete in foreign markets—when the trade figures had just shown for both 1960 and 1961 two of our largest favorable merchandise balances in peacetime history, considerably exceeding the 1950-57 average.

The Silence Continues

The Wall Street Journal, always pursuing its own *bete noire,* summarized the situation thus in an editorial last July: "Though a lot of confusion has developed about the payments deficit, the essential facts are perfectly plain. U. S. business enjoys a large export surplus; it is primarily the Government's policies at home and abroad that have created the deficit." *Business Week,* more judicious in tone but hardly more respectful of the facts, expressed a similar view at the same time in this fashion: "The plain—if disagreeable—fact is that the U. S. has committed itself to a considerably larger program of overseas military operations and foreign aid than it can finance within the present structure of international trade." Neither publication as much as mentions our stepped-up rate of investment, without which there would have been no dollar crisis. (Presumably, had we been investing $8 billion instead of $4 billion a year, and running a $7 billion final deficit, our government policies and commitments would still be responsible for all of it).

These inaccurate characterizations have influenced other periodicals to even more exaggerated comments. Typical, perhaps, would be one from my own newspaper, one of the country's largest: "International bankruptcy is the theoretical disaster facing the U. S. if the bad news about the puzzling imbalance of payments problem continues. . . . We owe more in world markets than other countries owe us. Our liabilities exceed our assets. . . . U. S. liabilities include imports, military expenditures overseas, investments in foreign enterprises, and foreign aid."

Note here the listing of foreign investments in the midst of our "liabilities," with the concomitant suggestion that we are on the verge of international bankruptcy. No wonder people have expected a cut in the gold value of the dollar, and some have transferred huge sums to Switzerland and elsewhere.

It took the British Chancellor of the Exchequer to set the situation in almost its proper perspective last September, by stating: "The nature of this deficit is a very special one. On current commercial transactions the U. S. has a massive surplus and the problem has arisen because of the enormous amounts spent abroad on aid, defense, and investment. It could be said that the problem is less one of a balance of payments than a balance of generosity." These words imply that our huge foreign investments are part of our "generosity" which is scarcely true; but they *resemble* generous deeds in that their continuance is purely voluntary.

I have been chiefly concerned by the failure of our leading economists to take the trouble to look the facts in the face and to pay adequate attention to the key role of foreign investment in bringing about our dollar crisis. Relevant quotations are too numerous to be feasible. Suffice to say that an authoritative volume, issued last year containing 13 essays on the subject by as many leading economists, devotes so little and so unilluminating discussion to the investment component to put the entire picture completely out of proper focus.

I am at a loss to explain what I consider a failure of professional competence. One explanation—which undoubtedly will seem plausible to many readers—is that my own diagnosis is completely incorrect. In self defense may I ask only that they go back over my data and my arguments, and consider them carefully before deciding who is right and who is wrong in this matter of transcendent importance.

FUTURE DANGERS AND POSSIBLE REMEDIES

Even though our problem may have arisen from a "balance of generosity," plus overseas investment, it did pose a real threat to the international position of the dollar. The improvement shown in the first half of 1962 does not in itself carry assurance that it will continue to the point needed to put the dollar out of danger. (I should place that point at an annual loss of liquidity of not more than, say, $1 billion).

Our foreign trade balance, so satisfactory for many months, may take a turn for the worse, and our military expenditures may have to be greatly increased. These appear more than outside possibilities in the atmosphere of real international crisis in which these words were written (October 28, 1962).

Assume that our liquidity loss is not sufficiently stemmed in the months to come, and assume that our foreign investments persist at their recent embarrassing rates; what steps can and should be taken to deal with the situation? It is obvious that we cannot rapidly step

up our merchandise exports sufficiently, by means of the plant modernization expected to follow the recent granting of tax incentives. The reliance on his procedure for a *quick* solution, constantly expressed by highly-placed officials, had overtones of absurdity.

A deep cut in our overseas expenditures by the government is not out of the question, but involves a basic change of policy at a time when world events seem strongly against it. A rise in interest rates to attract or retain *short-term* capital from abroad is already under way; but this cannot change our overall liquidity position—it only prevents conversion of our short-term liabilities into gold withdrawals.

Whether much *long-term* capital could be brought in by higher interest rates appears uncertain; in any event there is strong opposition to moving up radically our entire domestic interest-rate structure for this or any other purpose. Let us discuss three other possibilities.

The first is devaluation of the dollar. Whether that would really solve the problem is a matter of controversy. But how could we possibly justify such an "act of bankruptcy" if it is brought on by our persistence in investing huge sums abroad? Has any nation, corporation or individual ever gone bankrupt for such a fantastically inadequate reason?

The second possibility is obvious and logical. Let us cut our coat to our cloth—in other words, let us cut down our annual *new* foreign investments, net, to the amounts available for this purpose from all our other transactions. This would correspond to the normal behavior of an individual, who invests each year his surplus earnings above living expenses, taxes, and contributions.

The most appealing place to start such a policy would be in the area of foreign bond and stock flotations in this country. These have always been large, and appear to be larger than ever in 1962—reaching a rate of $1 billion or more.

Secretary Dillon has already indicated that, should the necessity arise, some steps to restrict that outflow of dollars will be taken. On the other hand, the compulsory reduction of our private investment abroad is opposed to our objectives of financial freedom. All of us would be reluctant to see such controls imposed—even though there is ample precedent therefor in the fiscal history of Great Britain.

To my mind the least objectionable way of dealing with the problem would be by means of *long-term* borrowings abroad made by our corporations and/or the U. S. Government. Our difficulty grows essentially out of our incurring short-term liabilities to foreigners to finance long-term investments made in their countries. The evident solution would be to finance long-term foreign investments, to the extent required, by long-term foreign borrowings. These do not reduce our liquidity balance, for the year, or in total, as do short-term debts.

Such a program would entail the payment of appreciably higher interest rates than on borrowings floated in the U. S. But if our new investments are sufficiently profitable we can afford to pay these larger borrowing costs against them. If they are not, we should not make them.

It is claimed that such borrowing is "impossible" because foreign capital markets are not well-enough organized. However, investors in the prosperous European countries are lending large sums to their own enterprises; some of our corporations have already borrowed abroad; securities payable at the lenders' option either in their own currency or in U. S. dollars would be especially attractive.

The question surely is not "Can we borrow abroad on long term?" but rather "How much will it cost us?" To balance this extra cost against the position of the dollar as the world's key currency, it is well to consider the relative magnitudes involved. One billion dollars worth of foreign borrowing at an extra interest cost of 1½% would involve an annual expense of $15 million. Place this amount in the context of our annual foreign accounts exceeding $30 billion on each side, and our Gross National Product of some $550 billion. If future threats to the dollar could be dispelled by expenditures in annual units of $15 million, the price paid would be a small one.

AIR REDUCTION
Company, Incorporated

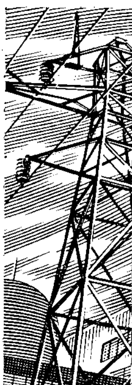
AIRCO 182nd CONSECUTIVE
COMMON STOCK DIVIDEND

The Board of Directors has declared a regular quarterly dividend of 62½¢ per share on the Common Stock of the Company, payable on December 5, 1962, to holders of record on November 19, 1962.

October 24, 1962.

T. S. O'BRIEN, *Secretary*

TOLEDO EDISON



Declares
A Common Stock
Dividend
of 20c a Share

for the
Third Quarter
of 1962
Payable October 26
to Holders of Record
October 5

J. P. Williamson, Sec'y.

REGULAR QUARTERLY
DIVIDENDS SINCE 1922

FEDERAL

FEDERAL PAPER BOARD CO., Inc.
Common & Preferred Dividends:

The Board of Directors of Federal Paper Board Company, Inc. has this day declared the following quarterly dividends:

50¢ per share on Common Stock.
28¾¢ per share on the 4.6% Cumulative Preferred Stock.

The Common Stock dividend is payable October 15, 1962 to stockholders of record at the close of business October 4, 1962.
The dividend on the 4.6% Cumulative $25 par value Preferred Stock is payable December 15, 1962 to stockholders of record November 29, 1962.

QUENTIN J. KENNEDY
Secretary

September 25, 1962
Bogota, New Jersey