

AMERICAN FOREIGN ECONOMIC POLICY,
THE DOLLAR SHORTAGE,
AND MR. BALOGH¹

I

Professor Harris' latest symposium should be of interest to laymen and professional economists alike. Its twentyfour authors cover in twentyfive chapters most of the important problems confronting the United States in the pursuit of their foreign economic policy. The discussions deal with past developments and with the possible desirable future course. All but one of the contributors are economists, who know their subjects well and often from the inside. Needless to say, even those contributors who are Government officials speak as private persons rather than as the authors or executors of the policies of their respective employers.

The reviewing of a symposium presents particular difficulties. Short of describing the contents of every essay it is impossible to do justice to every author. It may therefore be well to state at the outset that no slight is intended for the many essays which can only be mentioned. In spite of the fact that the essays cover a great variety of subjects, some features of American economic foreign policy emerge clearly from the reading of the book. The foreign economic policy of the United States is complex, and its authors are aware of this complexity. What is strikingly evident from the book, however, is first that the United States has acquired many responsibilities in the world during the last years and decades. This poses essentially long-range problems. It emerges secondly that the problem of the "dollar shortage" is the most pressing immediate problem although some disagreement exists as to whether this is a long run or a short run problem. The essays which will be discussed in detail will be primarily those dealing with this perplexing problem of the dollar shortage.

In a short introductory section the editor discusses the issues of policy involved, and Messrs. Thomas C. Blaisdell and E. M. Braderman of the

(1) This is a review article of *Foreign Economic Policy for the United States*, edited by Seymour E. Harris, Harvard University Press, Cambridge, Mass., 1948. pp. 490 + XIII, \$ 6.-.

US Department of Commerce outline the "Economic Organisation of the United States for International Economic Policy". The second part of the book deals with "Individual Country and Area Studies". Here Anglo-American, American-Canadian relations, the German problem, and our difficulties in Japan are discussed by John Cassels, Robert Bryce, Kenneth Galbraith and Robert Barnett respectively. Their contributions bring together the relevant facts both about the economies of the countries they are discussing and the problems which confront the United States in making up their official minds whenever economic and political considerations conflict.

From that standpoint, J.D. Sumner's chapter on American economic relations with China acquires particular relevance in view of the recent unpleasant developments in that corner of the globe. For Sumner's discussion leaves no doubt that, economically speaking, the United States have no great interest in China. Unless the 400 to 500 Million Chinese are expected at some unspecified future date to become good customers of a United States willing to wait that long, it is clear that American economic policy towards China was chiefly politically motivated. Similarly, H. C. Wallich's contribution makes it clear that no vital concern of the United States lies south of the Rio Grande.

Mr. Baran's discussion of the "USSR in the World Economy" claims that the Russian attitude towards international trade and international co-operation has been on the whole consistent with the general Marxian tenets of international and internal social policy. Russia's isolationism, her industrialization and re-armament programs are all designed to protect her from anticipated capitalist aggression. These policies need not conflict and have, according to the author, paid off during the war since they enabled the Soviet Union not only to produce great quantities of war materials but also to evacuate her industries relatively smoothly into the inner vastnesses of Russia.

Yet even Mr. Baran finds some puzzles too difficult to solve, although they are possibly of minor importance. Why for example did not Russia use her reputedly huge gold reserves to finance badly needed additional imports? Why did the Soviet Union refuse to join the International Monetary Fund or the International Bank? Even the case for Russia not joining the proposed International Trade Organization is not entirely convincing.

Mr Randall Hinshaw, previously known for a calculation (together with Lloyd A. Metzler) of the (then) future balance of payments of Great

Britain, re-examines the British balance of payments problem in the light of the recent American price rises. When the fighting ended in 1945, economists stressed the prime importance of the maintenance of high employment in the United States. This condition for world stability has now been met for three years running, yet the European difficulties have remained grave. Mr. Hinshaw points out, correctly in this reviewer's estimation, that Great Britain has very much more to lose if American prices and incomes were to fall, than she could gain by it. The high American prices have undoubtedly made some aspects of the British balance of payments problem more difficult than lower prices would have made it. But it is often forgotten that high American prices are, first a corollary of high American incomes. Secondly, high American prices mean, after all, not only that Britain has to pay more for her imports but also that it is easier for her to export. If American imports depended only on relative incomes in the United States and abroad, higher prices for both and imports would, of course, simply increase any existing deficit in the balance of payments. However, American imports are undoubtedly greater than they would be otherwise, precisely because prices here are higher.

II

The third part of the book is entitled "International Economic Co-operation". It contains chapters on the International Monetary Fund and the International Bank of Reconstruction and Development by A. G. B. Fisher; on the General Agreement on Tariffs and Trade negotiated in Geneva in 1948 by W. G. Brown; a discussion of the International Trade Organization by H. G. Hawkins which needs little change inspite of the fact that it was written before the end of the Havana Conference. I should like, however, to concentrate on Mr. Gutt's discussion of "Exchange Rates and the International Monetary Fund" (pp. 217-235).

Mr. Camille Gutt is the Chairman of the Executive Board and the Managing Director of the International Monetary Fund. His contribution is a candid and often convincing discussion of the reasons which have induced the officials of the International Monetary Fund to accept exchange rates which were manifestly not correct, and in general of the reasoning underlying the Fund's decisions. Mr. Gutt does not evade the problems and points out that the Fund has not evaded them. There may simply not have been any "correct" exchange rate in 1946. When the Fund accepted the proposed exchange rates it simply "wanted to know

whether the prevailing exchange rate would handicap a country in rebuilding its economy and in securing an orderly adjustment to its new international economic position" (p. 221). As long as the exchange rate did not seem to handicap exports of available goods and enabled countries to import it was accepted regardless of whether it was considered a reasonable rate in the long run. "At least until the last of 1947 the initial parities do not seem to have been a handicap to members of the Fund in expanding their total exports" (p. 221). Therefore, Mr. Gutt believes that "if the necessary changes are made promptly, the wisdom of the original action will be supported" (p. 221).

Mr. Gutt makes a good case for not having accepted alternative policies at the time. In particular, as long as American aid is available (a qualification not mentioned by the author) it is obviously useless to establish an exchange rate parity forcing countries already desperately short of goods to export more. Of course, parities should be changed when necessary. And of course internal monetary policies should not be such as to jeopardize through later developments *any* parity which might at the time of its setting have been quite reasonable. Yet Mr. Gutt recognizes explicitly that "if there have been delays in getting an obviously necessary change in the parity of one of the major currencies, the French franc, it is because political disturbances prevented such measures from being taken earlier ..." (p. 224).

Needless to say, this brief account does not do full justice to Mr. Gutt's important essay. But it ought to have served to draw the attention of the interested reader to the existence of this most authoritative interpretation of the International Monetary Fund's actions.

At the same time the interested reader is referred to an important criticism by Professor Bresciani-Turroni of Mr. Gutt's comments on the "disorderly cross rates" which have recently arisen with respect to the dollar, the pound, and the French franc. Professor Bresciani-Turroni's analysis (1) shows that "In a free market this discrepancy between direct and cross rates derives necessarily from the existence of bilateral trade relations (2)".

Bresciani-Turroni points out that "the deformation of trade is not the consequence of disorderly cross rates. On the contrary, it is the deform-

(1) Banco di Roma, Review of the Economic Conditions in Italy, Vol. II No. 3, May 1948, pp. 147-155

(2) *Op. cit.* p. 151. The passage quoted is italicized in the original.

ation of trade currents, caused by bilateral agreements, that renders a general equilibrium of foreign exchange rates impossible" (p. 153). "Disorderly" cross rates will actually tend to correct at least partially the dollar shortage which is the basis for their existence. Therefore, Professor Bresciani-Turroni concludes that "... the solution of the problem is not to be found in an intensifying of controls with a view of achieving a monetary balance which, I repeat, I consider impossible as things are at present. A solution of the monetary problem is only to be reached through a more extensive and intensive cooperation among the Governments in order to do away with bilateral agreements replacing them with commercial treaties facilitating the creation of a multilateral system, in the spirit of the recent Havana Convention" (p. 155).

III

The fourth part of the book deals with the European Recovery Program. Here we meet our one non-economist, Kirtley F. Mather who discusses "American Resources in Relation to Europe's Needs" from the geologist's standpoint. Calvin Hoover's discussion of "What Can Europe Do For Itself" and Sidney Alexander's discussion of "Europe's Needs and Prospects" are both based largely on the Paris reports of the sixteen participating nations, the Harriman report and other American documents. Lincoln Gordon contributes a penetrating account of the administrative problems involved in the formulation of policies for the European Recovery Program.

In a brief but penetrating chapter, Professor Edward S. Mason considers the European Recovery Program in the political context of American foreign policy. He argues convincingly that American-Russian relations ought to improve as the European Recovery Program succeeds. Obviously, world peace depends on how these two great nations get along. Professor Mason finds Russian behaviour as consistent as did Mr. Baran, although possibly for slightly different and to this reviewer more convincing reasons. "Whatever else the Russians lack ... they do not lack a sense of history. In fact they have, ready made, a 'scientific' interpretation of history which is not only equipped to explain the past but to predict the future. This interpretation of history tells them that time is working on their side. And if time is working on their side, why should they yield in negotiation to-day that which the inevitable course of events will bring them to-morrow?" (p. 292.) Thus Professor Mason concludes: "Under

these circumstances, the only effective line of action open to us is to attempt, ourselves, to influence the course of events. To me this is primary significance of the new approach of American foreign policy. If the Marshall Program is successful and the participating countries are firmly established on the road to recovery, we may reasonably expect to see the increasing stability and strength of democratic governments not only in Europe but elsewhere in the world. If and when this happens, we may also reasonably expect to see a change in the Soviet forecast, with consequent improvement in the prospect of achieving agreement through the process of negotiation. After all, this would not be the first time, that Soviet truculence based on a faulty forecast has given way to sweet reasonableness once the falseness of the forecast has been demonstrated by the course of events" (p. 292/3).

IV

The final part of the book deals essentially with the problem of the so-called dollar shortage. Its contributors are Hansen, Haberler, Samuelson, Triffin and Balogh. All authors have much to say. For the theorist as well as for the practitioner this section is apt to be most interesting as well as the most irritating one. For it is impossible not to be irritated either by Professor Haberler (who is not quite as "orthodox" as Mr. Harris in an editorial comment suggests) or by Mr. Balogh. This reviewer's irritations all stem from Mr. Balogh's contribution for reasons which will be spelled out in detail below.

Samuelson argues that adjustments in the exchange rates would not have by themselves abolished the "dollar shortage". In fact he insists that "one can hardly argue that the very real problem of 'universal' dollar shortage arose primarily out of differential price movements of the usual sort. The reverse is, in my opinion, more nearly true" (p. 399). Whether or not this is so can be left open here although Samuelson is, of course, certainly right in stressing the point that the relation between price movements and the foreign exchanges are not all one way. Samuelson then argues that "the equilibrating efficacy of exchange rate variations does not depend upon each of the two countries having an elastic demand. The critical question is now recognized to be whether the sum of the two elasticities—the 'net elasticity'—is greater than unity" (p. 404).

On the other hand, Samuelson points out (what is perhaps selfevident), that as long as rich countries are willing to lend to poorer countries they

can undersell them (in a particular sense of the word) in every line of endeavour—the theory of comparative cost notwithstanding. To which need only be added that the theory of comparative cost would still show which particular goods the creditor country should and would export. Samuelson further insists that it is “natural” for poor countries to go into debt to rich countries, and that it is equally “natural” for them to default. It may be asked whether it is also “natural” that the rich country should continue to lend even if the poor countries default periodically.

This account is historically more or less correct for, say, the past hundred years. At present Europe evidently is poor and the United States are rich, and they are willing for a variety of reasons not only to lend but to give. Ergo ... In any case, while monetary mismanagement undoubtedly is part of the story of the dollar shortage, it is not quite the whole story.

Now Professor Haberler, who is represented by two contributions takes, of course, a line which in spite of its supposed orthodoxy is not so very different. In fact, it should not be too difficult to reconcile this “orthodoxy” of Haberler and the “unorthodoxy” of Samuelson (1). No one who has recently been in Europe can possibly deny that the root cause of the European troubles are not monetary alone.

But from that it hardly follows that monetary mismanagement is even largely irrelevant. In particular, Professor Haberler points out that the situation is quite different for different countries. For Greece or Germany balanced international accounts now without American aid would mean starvation and chaos. For England and France, however, this is by no means certain although it is certain that to balance their foreign accounts now without American aid would involve a lowered standard of living immediately and possibly through a less ambitious investment program, also in the future. “It is economically very fortunate and socially and politically imperative that through the Marshall plan the transition to a balanced trade position be prolonged or postponed for some time, but economically speaking for Western Europe, foreign aid (and loans) is no longer a question of life and death as it is for the first mentioned group of countries” (p. 434).

(1) It might be noted in passing that the most “orthodox” contribution to his section comes surprisingly from the pen of Professor A.H. Hansen who most nearly insists on the formulation and usefulness for purposes of exchange rate determination of a purchasing power parity theory which is based on cost-price relationships.

One could perhaps go even further than Professor Haberler does. It seems often implied not only that in France, to take an example, anti-inflationary measures would not do much good to avoid a "permanent" dollar shortage (which is doubtful but conceivable) but that somehow France is enabled to consume and/or invest more than she could if she applied herself more assiduously to slightly sounder finances. But this is obviously nonsense. The first law of economics is that one cannot eat more than one has (including one's capital). France cannot consume and/or invest a bit more than her own resources and the additional resources she can get through Marshall aid and so forth, permit. When Mr. Harrod, for example insisted that Britain was trying to do too much, this can hardly be denied: overambitious plans will be limited either by the "dollar shortage" and exchange controls, or by means of disinflation as the strange twin of deflation is nowadays called. The bad effects of inflation, whether suppressed or open, are such that it needs to be proved that the gains of exchange control are greater than the losses of inflation. I am neither a deflationist nor an anti-exchange control advocate under all circumstances; what Europe has seen in recent years, however, goes undoubtedly beyond any reasonable and justifiable degree of control.

When it comes to countries like Sweden, Canada, Argentina, or Australia, all of whom have not suffered directly from the war but like the United States have developed further (Mr. Balogh take note!) it is obviously impossible not to agree with Professor Haberler that "these countries suffer from a balance of payments deficit *pur et simple*, unaccompanied by the alleged impossibility of living within their means" (p. 434). This seems so obviously true that "unorthodox" economists tend to overlook this aspect of the problem. Professor Haberler could have strengthened his case by a reference to Switzerland which does not suffer from a dollar shortage although she is in a rather more difficult position than, say, Sweden, which does.

Thus Professor Haberler concludes that "the classical, inflation theory of the dollar shortage is substantially correct". But "it would be a serious misunderstanding to believe that the problem is simple or easy to solve, because we have reduced it to a short formula" (p. 444).

In fact, both Haberler and Samuelson can be reconciled as far as their *theoretical* statements are concerned. The following picture of a "permanent" dollar shortage might be constructed. European nations have lost much of their productive power through the war, but their people have

not yet adapted their consumption pattern to their new poverty and aim at a prewar standard or even higher. They refuse to save enough. In order to make ends meet, nationally as well as internationally, rationing and exchange controls have to be used.

It might further be argued that the traditional anti-inflationary policies would not do much good as long as this desire to maintain or improve prewar consumption levels continues. Such policies would undoubtedly reduce prices and incomes in terms of domestic currencies, but they might conceivably reduce only the numéraire of the Walrasian system. That is, the consumption function in real terms might remain just where it was, which was too high. While the price mechanism may fail to depress the consumption function or may do so only at the cost of a politically and socially intolerable redistribution of incomes, rationing and exchange control will necessarily succeed.

This is a theoretical construct which is undoubtedly conceivable although I should not consider its real existence very probable. In any case it involves questions of *fact* about which legitimate differences of opinion may exist.

V

It is also my duty to review Mr. Balogh's contribution on "The US and International Economic Equilibrium". It is not easy to understand why Mr. Harris has chosen to conclude his symposium with this essay. Mr. Balogh is the only English contributor. But it would be most unfortunate if this fact led the reader to believe that Balogh represents the English viewpoint. In fact, neither the British Government nor British Economists from the late Lord Keynes to Hicks and Harrod agree any more with him than do most American economists and for the same reasons. Mr. Balogh's contribution is a mixture of brilliant and bad analysis, of illegitimate application of this analysis to alleged facts, and of special pleading to permit England with impunity to behave in a Schachtian way which is not less evil because it applies to England and comes from a fellow of Balliol College, Oxford.

These are serious charges which must be substantiated. Balogh starts out with a review of the assumptions of the classical theory of international trade. Among them he mentions casually that "the balance of payments must be in equilibrium in the sense that income and outlay are equal" (p. 447). This, however, is *not* an assumption but an equilibrium condition.

It is true that cyclical considerations were not taken into account by the earlier classical economists, but this hardly justifies the statement that 'there would be no level of exchange which would both balance the country's international payments and permit the maintenance of full employment' (p. 448). This would be an important point if true. If Balogh had been content to state that no one has thus far produced a proof that full employment is possible simultaneously in all countries at specific exchange rates and without exchange control, he would have been more nearly correct. But even then most economists would think that the burden of proof lay with Mr. Balogh.

"We have seen" Mr. Balogh continues "that once the possibility of a serious deflationary instability in an important member country of the system is admitted, multilateral schemes cannot *a priori* be expected to secure optimum progress for all members of a world system" (p. 445). This may be so, but it would require some discussion of the meaning of optimum progress, and it would require proof on Mr. Balogh's part. Neither have been given. But suppose, for arguments sake, that Mr. Balogh's assertion be correct and suppose that we agree also that "if we apply the modern theory to the balances of payments we must immediately recognize how vastly important is the size and especially the relative size of units" (p. 451). If a country is big enough "an inflow or outflow of gold will not enforce a change in monetary policy. Nor will the income effects which give rise to these gold movements ... significantly alter, or cause a country to alter, its own national income because of its preponderance in the total world money income" (p. 445). Thus Mr. Balogh concludes "the larger the 'leading' country and its national income relative to the world, the greater its instability relative to that of the world, the more fluid its cost structure and the more important its products, the greater will be the instability of the system as a whole" (p. 453).

All of this obviously applies to the United States and probably only to the United States. It is an interesting analysis and may become quite relevant at some future date. It possibly overestimates the importance of America in the world. It overlooks the fact that the United States might be willing, for reasons of international cooperation, to pursue voluntarily monetary policies into which it cannot be forced. But how is this relevant to the immediate problem? Since the end of the war no instability, nor any depressing influence, has emanated from the United States. Yet Mr. Balogh simply rephrases what he wrote in 1946 in anticipation of a de-

pression in the United States. Perhaps he will be correct in the future. Perhaps the United States will have a depression. But the point is that for the past three years she has not. This does not prevent the author from writing: "It is thus not true that it is *merely stability* in the United States (and other large economic units) that is required for a smooth working of a multilateral international system, *but stability at high employment*. A long depression in one country—if the country is big enough—is a perpetual menace to the world economic system, because of the direct and indirect (psychological) pressure it exerts on other countries" (pp. 457/8. Italics in the original).

An impartial observer would think that a stable high level of production and employment is exactly what we have had in this country for the past three to four years. He might even agree with Dr. Balogh that because of the importance of the domestic economy of the United States "the possibility of influencing the United States level of employment by export surpluses had practically vanished ... the existence of a relatively large surplus in her balance of payments will hardly have any effect on her internal position" (p. 458). But this is rather difficult to reconcile with the statement found only two pages later where the European Recovery Program is suggested to have helped save the day for the American economy!

In reality, of course, the facts do not support Mr. Balogh even if we accept his second view. For the European Recovery expenditures were made at a time when the Federal budget ran a *surplus* of \$ 8 billion and more over and above ERP expenditures, armaments, and the rest of the "day saving" expenditures. *And* in addition, inflationary pressures continued even with so large a budget surplus. Surely the ERP expenditures accomplished nothing for the American economy which a tax reduction could not have done equally well.

But Mr. Balogh is not content to show the dire consequences to the world of an American depression. Nor is he content simply to ignore the fact that during the past three years and more the American economy has fulfilled all the conditions he postulates for a successfully working international economy. The world still experiences considerable difficulties, but "stability at high employment" in the United States does not exonerate this country. His attitude towards the United States that "heads I win, tails you lose" is beautifully illustrated by the following arguments: If the United States should experience a depression the world would be unable to export enough to America. Would an American boom help in this

respect? Not a bit. Prices have risen faster than wages, reconversion has proceeded faster than anticipated, employment is at an all time high for peace times. The conclusion from all this is not, as one would expect, that this has provided at least *temporary* relief for a dollar starved world. On the contrary, the author concludes in the very next sentence: "Only a prolonged series of strikes could produce a situation in which foreign countries would be safe from United States competition. This is at least unlikely, especially in view of the trend of Congressional opinion" (p.460).

Having assured us that both booms and depressions in the United States are equally harmful to the world and that only a high and sustained level of strikes in this country can save the world from American competition, Mr. Balogh continues: "Yet even if such a complicated system of multilateral discrimination" (as envisaged by the International Trade Charter and amended by Mr. Balogh) "were to be accepted by the United States, it still seems important to emphasize that, without obtaining permission for long-term reciprocal purchase agreements, or other preferential agreements, Western Europe will not be able to insure real stability nor will it be able to create really large-scale and secured markets. Even if American instability is guarded against, the principle of nondiscrimination as applied by the Havana Charter will tend to perpetuate the present superiority of the United States in relation to other industrial exporters" (p.474).

This statement and its implications are grossly unfair and run counter to the known facts. In the councils of the European Recovery Program, is not the United States urging the European nations to get together? To be sure, sufficient instances of peculiar behavior on the part of American authorities can be found to make the United States appear considerably less than perfect. Nevertheless, it is not correct that the United States would not accept anything short of complete customs unions, as Mr. Balogh implies at a later place. Indeed Mr. Harold Wilson did not complain about the United States but rather about France for preferring to import goods available in Great Britain from the United States where they could be had as a gift. It would seem then that only the cutting off of American aid would force European unity! It is rather difficult to see how special privileges would create anything but a greater division of Europe rather than a larger market.

It is therefore rather odd to read "it is this persistent discrimination against efforts to establish a large-scale economic territory in Europe and its complementary areas capable of development on the basis of long-

contained in the postwar agreements" (p.477/8). It is surely libelous to term planning (and the permission to form full customs unions is both impractical and irrelevant) which is the real threat against our future state and to imply that "the fact that neither the General Agreement nor the Charter outlaws tied loans—a most powerful and discriminating means to promote exports—shows that the United States, well aware of its war-promoted superiority, means to retain it" (p.478).

It can hardly have escaped Mr. Balogh, first, that tied loans form only a minute part of American loans. He must have known, secondly, that the United States encourages maximum spending of ERP dollars abroad (1). In any case, as long as everyone wants dollars a tying provision would be irrelevant anyway. Furthermore, if the United States is as superior in all respects as Balogh says, it obviously needs no permission to make tied loans, and such a permission would aid rather Great Britain to maintain her exports *against* this supposed general, universal and inevitably growing American superiority.

It can, finally, be categorically stated that not one nation, not even Great Britain, proposed either at London, or at Geneva, or at Havana to outlaw tied loans, and that this question was never raised at any of these conferences. Coming after the \$ 3¾ billion untied loan to Great Britain, and considering the off-shore purchase provisions of the Marshall Plan aid, this statement is particularly difficult to understand.

In spite of his scientific guise, Mr. Balogh pleads a case for British policies of discrimination. He does not seem to care whether he uses arguments which are internally or mutually consistent; he does not apparently care whether his facts are correct or relevant. The application of the arguments, even when the arguments by themselves are sound, is often illegitimate. The insinuations are tactless and without foundation. It is painful to watch a good mind misused. By concluding this distinguished volume with Dr. Balogh's paper, Mr. Harris has cast him in the natural rôle of *advocatus diaboli*.

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(1) It is unfortunately true that half of the purchases made *in* the United States with ERP dollars should be shipped in American vessels. This provision does not, however, apply to offshore purchases. Shipping done in American ships must be at world market rates. And in any case, there is no requirement that a single ERP dollar be spent within the United States.