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UNITED STATES FOREIGN POLICY

WORLDWIDE AND DOMESTIC ECONOMIC
PROBLEMS AND THEIR IMPACT ON THE
FOREIGN POLICY OF THE UNITED STATES

A STUDY

PREPARED AT THE REQUEST OF THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

BY

THE CORPORATION FOR ECONOMIC AND
INDUSTRIAL RESEARCH, INC.

(Pursuant to S. Res. 336, 85th Cong., and S. Res. 31,
86th Cong.)

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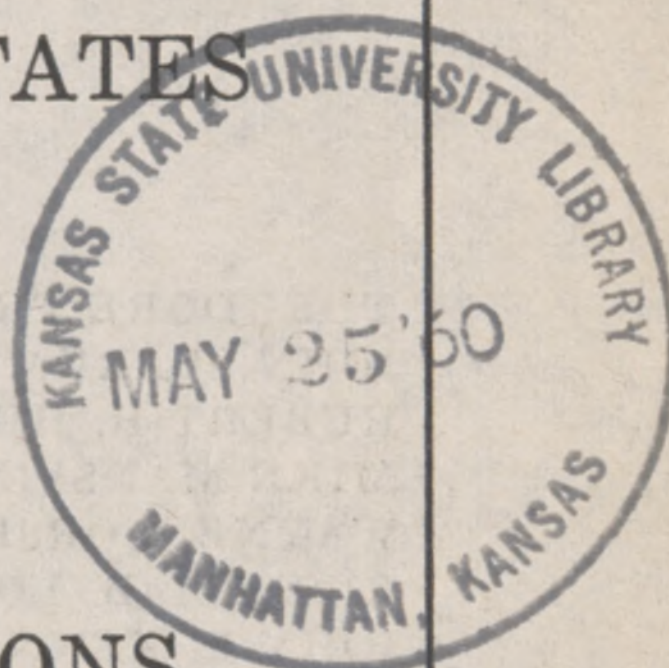


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PREFACE

By Senator J. W. Fulbright, Chairman,
Committee on Foreign Relations

In January of 1958 the Committee on Foreign Relations decided to undertake a review of conditions and trends in the world and of the policies and programs of the United States with respect thereto. That review grew, in part at least, out of the concern of the committee over the impact which Soviet scientific achievements might have upon our relations with the rest of the world.

From time to time throughout the spring of 1958, the committee held public hearings on U.S. policies respecting the Far East, the Near East, south Asia, Africa, Europe, Latin America, and Canada. Those hearings were limited in nature and served primarily to focus attention on the principal policies and problems of the United States in its relations with the rest of the world. For the most part, the hearings were limited to receiving testimony from the principal officers of the Department of State concerned with various geographic parts of the world. The committee also sought the testimony of selected nongovernmental witnesses with special knowledge of the areas under examination.

The hearings during the spring of 1958, the focus given to our relations with Latin America as a result of Vice President Nixon's visit there, and, lastly, the then critical situation in the Middle East, all contributed to the committee's belief that the time had come for an exploration in depth of U.S. foreign policies throughout the world.

As a consequence of these factors, the Committee on Foreign Relations, in an executive session on May 20, 1958, authorized its Subcommittee on American Republic Affairs to undertake a study of U.S.-Latin American relations. At the same time the committee established a special subcommittee, consisting of Senators Green, Fulbright, Wiley, and Hickenlooper, and directed it to explore the feasibility and desirability of a broad study of U.S. foreign policy throughout the world.

Subsequently, this subcommittee reported to the full Committee on Foreign Relations that it was feasible and desirable that the committee undertake such a study of foreign policy. It was felt a study of this nature might serve to develop fresh ideas and approaches to the foreign policy of the Nation and lead to a better national understanding of international problems and to more efficient and effective administration of our international operations.

On July 15, 1958, the Committee on Foreign Relations voted to report to the Senate a resolution authorizing the study. The Senate adopted this resolution (S. Res. 336, 85th Cong., 2d sess.) on July 31, 1958. The resolution authorized the Committee on Foreign Relations to "make a full and complete study of U.S. foreign policy." Without

limiting the scope of the study authorized, the committee was instructed to direct its attention to the following subjects:

1. The concepts which govern the relations of the United States with the principal nations and geographic areas of the world, and the policies by which these concepts are pursued;

2. The present state of the relations of the United States with the principal nations and geographic areas of the world;

3. The administration and coordination of policies and programs by the Department of State and such other departments and agencies of the executive branch which engage in substantial activities abroad; and

4. The relationship of other policies and activities of the Government and private activity which exert a significant influence on the relations of the United States with the rest of the world.

In the conduct of its study the committee was authorized to "use the experience, knowledge, and advice of private organizations, schools, institutions, and individuals * * *" and to "enter into contracts for this purpose." It was directed to complete its study by June 1960, and not to exceed \$300,000 was made available to meet the expenses of the committee. The committee was authorized to continue this study by the terms of Senate Resolution 31 (86th Cong., 1st sess.).

Shortly after Senate Resolution 336 was adopted by the Senate, Senator Green, then chairman of the Committee on Foreign Relations, designated me to serve as chairman of an executive committee, consisting of Senators Sparkman, Hickenlooper, and Aiken, which was given the responsibility for directing and coordinating the study.

On September 16 and 17, 1958, the executive committee discussed with a group of distinguished private citizens the general problems involved and the most advantageous approaches to them. Taking part in these discussions, besides the members of the executive committee, were Robert Bowie of Harvard University, former Ambassador William G. Bullitt, Robert Calkins of the Brookings Institution, John Cowles of the Minneapolis Star and Tribune, William Diebold of the Council on Foreign Relations, Henry Luce of Time-Life, Inc., Walter Millis of the Fund for the Republic, and Dean Rusk of the Rockefeller Foundation.

Following these meetings, the executive committee developed its plans and announced, on October 15, that it was prepared to invite private research organizations and institutions to submit proposals on a series of 15 studies which the committee expected to have undertaken in connection with its examination of foreign policy. As a result of this announcement, the committee received over 50 proposals from organizations and institutions interested in undertaking one or more of these studies.

On January 5, 1959, the executive committee met again to consider the proposals which had been received and decided which organizations and institutions should be asked to undertake studies for the committee. Set forth below are the titles of the studies being undertaken and the names of the organizations and institutions responsible for these studies.

STUDIES

Study I-A. The Nature of Foreign Policy and the Role of the United States in The World. Council on Foreign Relations, Inc., 58 East 68th Street, New York, N.Y.

- Study I-B. The Operational Aspects of U.S. Foreign Policy. Maxwell Graduate School of Citizenship and Public Affairs, Syracuse University, Syracuse, N.Y.
- Study II. The Principal Ideological Conflicts, Variations Thereon, Their Manifestations, and Their Present and Potential Impact on the Foreign Policy of the United States. Center for International Affairs, Harvard University, 6 Divinity Avenue, Cambridge, Mass.
- Study III. Worldwide and Domestic Economic Problems and Their Impact on the Foreign Policy of the United States. Corporation for Economic and Industrial Research, Inc., 1200 Jefferson Davis Highway, Arlington, Va.
- Study IV. Foreign Policy Implications for the United States of Economic and Social Conditions in Lesser Developed and Uncommitted Countries. Center for International Studies, Massachusetts Institute of Technology, Cambridge, Mass.
- Study V. Possible Developments in Military Technology, Their Influence on Strategic Doctrine, and the Impact of Such Developments on U.S. Foreign Policy. Washington Center of Foreign Policy Research, The Johns Hopkins University, 1906 Florida Avenue NW., Washington, D.C.
- Study VI. Possible Scientific Developments and Their Potential Impact on Foreign Policy of the United States. Stanford Research Institute, Menlo Park, Calif.
- Study VII. The Role of Multilateral Organizations in the Formulation and Conduct of U.S. Foreign Policy. The Brookings Institution, 722 Jackson Place NW., Washington, D.C.
- Study VIII. Formulation and Administration of U.S. Foreign Policy. The Brookings Institution, 722 Jackson Place N.W., Washington, D.C.
- Study IX. U.S. Foreign Policy in Western Europe. Foreign Policy Research Institute, University of Pennsylvania, Philadelphia, Pa.
- Study X. U.S. Foreign Policy in the U.S.S.R. and Eastern Europe. The Russian Institute, Columbia University, New York, N.Y.
- Study XI. U.S. Foreign Policy in the Near East. Institute for Mediterranean Affairs, Inc., 27 East 62d Street, New York, N.Y.
- Study XII. U.S. Foreign Policy in South Asia. Conlon Associates, Ltd., 310 Clay Street, San Francisco, Calif.
- Study XIII. U.S. Foreign Policy in Africa. African Studies Program, Northwestern University, Evanston, Ill.
- Study XIV. U.S. Foreign Policy in the Far East and Southeast Asia. Conlon Associates, Ltd., 310 Clay Street, San Francisco, Calif.

Each of these organizations and institutions will submit a study to the committee.

Broadly speaking, I hope these studies will supply essential background to enable the Committee on Foreign Relations to accomplish the following basic purposes:

1. Provide the Senate and the American people with a simple, understandable, and forthright statement of the basic foreign policy aims of the United States which reflects the motivations and aspirations of the American people.
2. Identify those forces, domestic as well as foreign, which now or in the future may tend to frustrate or to promote the basic foreign policy aims of the United States.
3. Suggest, and if possible, determine, feasible ways to deal with such forces so that they may promote the basic foreign policy aims of the United States.
4. Examine the impact of those forces and trends, foreign and domestic, upon the conduct of American foreign policy in the various geographic areas of the world.
5. Examine the foreign policy decision-making machinery to determine whether it is of the maximum efficiency consistent with our democratic processes.

At the January 5 meeting the executive committee also decided to send a letter to some 50 retired Foreign Service officers "to endeavor

to obtain for the use of the committee the personal views of men of practical experience with respect to the foreign policy of the United States." Each of these retired Foreign Service officers was asked to give the committee his "general commentary on what is right with our policies, what is wrong with our policies, and what action (or inaction) might in your opinion best serve our interest in the future."

On June 15, 1959, the committee made public, in a summarized form and without personal attribution, the substance of the views of former members of the Foreign Service who responded to the letter. The views and attitudes expressed in that committee publication deserve the most careful consideration by officials in the executive branch of the Government, by my colleagues in the Senate, and by all citizens interested in the conduct of our foreign policy.

The study printed in this volume, "Worldwide and Domestic Economic Problems and Their Impact on the Foreign Policy of the United States," is the first of the 15 principal studies to be published by the committee. It was designed to help the committee find answers to subjects covered in an outline developed in consultations between representatives of the committee and representatives of the Corporation for Economic and Industrial Research. A copy of the outline appears in the appendix. (See p. 91.)

I take this occasion to emphasize that the studies which are received will supply the committee with background material for consideration in preparing a final report to the Senate. The committee is, of course, free to accept or to reject the findings and recommendations of the organizations and institutions submitting studies. It is the function of the committee to evaluate the studies which are submitted. Prior to the preparation of a final report, the committee will hold public hearings to receive testimony from all interested parties. In that way it will be possible for the committee to test the soundness of the findings and recommendations in these studies before reaching its own conclusions and submitting its final report to the Senate.

In addition, I wish to emphasize that the committee is approaching this assignment in a nonpartisan manner, endeavoring to avoid transitory issues and to concentrate on the fundamental forces at work within and without the United States which must be understood if our foreign policy is to serve the Nation.

INTRODUCTORY COMMENTS

The Corporation for Economic and Industrial Research, Inc. (CEIR) wishes to acknowledge the vital contribution made to this study at all stages by the consultant project director, Dean Arthur E. Burns, chairman of the graduate council of George Washington University. Dr. Burns helped organize the study, prepared basic drafts, and developed the final report in conjunction with the officers of the corporation. He also served as chairman of the advisory board selected by CEIR to review critically the analysis, conclusions, and recommendations of the study. Dr. Wilson E. Schmidt of George Washington University contributed importantly to the preparation of chapter 4.

We are indebted to the members of the advisory board for the part they played in the development of the conclusions and recommendations. The board's comments and advice with respect to the many questions and problems dealt with in this study were penetrating and constructive.

The members of the advisory board were:

Dr. Arthur E. Burns (chairman), George Washington University;

Dr. Reynold E. Carlson, director, Department of Economics and Business Administration (director, graduate program in economic development), Vanderbilt University;

Dr. Ernest Griffith, dean, School of International Service, American University (formerly director, Legislative Reference Service, Library of Congress);

Mr. Frank D. Newbury, economic consultant; formerly Assistant Secretary of Defense for Research and Development; and

Mr. Wayne C. Taylor, formerly President of the Export-Import Bank.

We are also pleased to acknowledge the assistance and information received from many Government officials at the research stage of this study. The material presented in this report, however, is completely the responsibility of CEIR, Inc., and does not necessarily represent the views of either the members of the advisory board or of the Government officials consulted.

In addition to the active participation in the project by Dr. Herbert W. Robinson, president of CEIR, and Mr. O. Rudolph Johnson, vice president, the following members of the corporation's staff contributed substantially to the development of the study. Mr. David J. Steinberg, director of the international economics branch, CEIR, was staff director for the project and secretary of the advisory board. Among other CEIR staff members, Jack Faucett, director of the data research division; Dr. William G. Friedrich, economist; Dr. John Hardt, Soviet bloc specialist; and Kung-Lee Wang, international economist, made particularly valuable contributions.

WORLDWIDE AND DOMESTIC ECONOMIC PROBLEMS AND THEIR IMPACT ON THE FOREIGN POLICY OF THE UNITED STATES

I. CONCLUSIONS AND RECOMMENDATIONS

A. THE COMMUNIST THREAT

The fundamental fact which dominates our foreign policy problems is the determined, relentless intention of the Soviet Union to control the world. It is important that the United States realize this is not an idle threat, because the unusually rapid industrial growth of the Soviet Union adds menacing power to its designs.

Unfortunately, our military and foreign aid programs have been sufficient thus far only, so to speak, to buy limited "term insurance" against this threat. And at each renewal the premium has increased. To face the facts of future Soviet power politics, we must think in terms of a 10- or 20-year "endowment policy" of adequate size. The "term insurance" premium as it grows might reach excessive and needless levels. An adequate endowment policy is well within our capability because the free world has at present four-fifths of the world's income and two-thirds of the world's population. America's foreign policy must increasingly seek to mobilize these free world resources for the military and economic programs necessary to frustrate Soviet designs.

This report is concerned with a number of economic problems important to foreign policy over the next decade. The necessity to maintain substantial military forces will in many ways shape our economic problems. Certainly, vigorous growth in the American economy is essential to assure the material resources required to support these forces. Economic growth is a requisite also to back up other foreign policy commitments, in particular the promotion of economic growth in the underdeveloped countries.

These claims on our resources, and on those of our allies, must be met because (1) the U.S.S.R. is prepared to use force wherever it believes force will pay off, and (2) the U.S.S.R. is undertaking a varied offensive against the vulnerable parts of the free world—the underdeveloped countries. The cost of meeting both threats is the long-run premium for our security insurance. To consider one and not the other, or to pose the issue "military versus economic aid," overlooks the multipronged offensive we are facing. This country and its allies have the resources to handle both costs.

Because the Soviet Union has a formidable military capability, the United States and our allies must maintain decisive superiority both as to technical quality and striking power of the military forces. Rapid obsolescence of weapons now in being offers the opportunity

to assure this objective—if sufficient resources are put into the effort. Some of the opportunities at hand are (a) the rapid development of an effective anti-ICBM-missile defense before the Soviets achieve it, (b) full exploitation of all military applications of our vast superiority in electronic data processing and computer production, and (c) the expansion of our capability to assemble and place quickly, anywhere, by air and sea, highly mechanized and powerful forces to prevent Communist expansion by “local” conventional warfare.

These cost heavily, but the United States and its allies have a 3-to-1 superiority in economic resources over the Communist bloc. The pooling of these resources through military aid, defense support, and related assistance, and through technical cooperation involves a common sharing of the premium for security insurance. This premium is likely to rise in the years ahead; it must if this country and its allies are to maintain the decisive advantage of technical superiority.

Programs of military aid, defense support, special assistance, and contingency aid have built up the free world perimeter against the Communist forces menacing it. Perhaps the success of this policy explains the shift of recent years in the Soviet offensive—now aimed at outflanking the perimeter by concentrating on the underdeveloped countries, principally those of the Middle East and Asia at this time. Internal subversion, psychological warfare, and the fact or promise of economic assistance and increased trade all play their part. These aspects of the Communist offensive also call for concerted action and the heavy commitment of resources by the United States and its allies.

Rapid economic growth gives the Soviet Union the capability of extending its influence into the underdeveloped countries through trade and aid, and by the sheer attraction its rapid growth might have as a model to these countries. Soviet portrayal of the West as exploiters and imperialists is coupled with promises of sharing out the wealth of the West to those who know nothing but poverty. This has dangerous attractions.

The aims of the Soviet Government are clearly visible in the resolution of the 21st Congress of the Communist Party of the Soviet Union on the 1959–65 economic development program of the U.S.S.R. which aims at the Soviet bloc reaching 50 percent of the entire industrial output of the world by 1965. The description of this 7-year plan, and the 15-year plan of which it forms part, is clearly designed for immediate foreign as well as domestic consumption. The 15-year targets are incapable of fulfillment, but the full fruits of the propaganda will, they hope, have been reaped long before recognition of this fact by the peoples of the underdeveloped countries can any longer affect their fate. Extracts from the resolution are full of significance:

The fulfillment of the targets set by the party and the government for the next 7 years will have tremendous importance in further strengthening the *might of our country*. [CEIR italics.]

“The successes * * * will be a new expression of the advantages of socialism over capitalism and will to a still greater extent increase the *power of attraction of the great ideas of Marxism-Leninism*.” [CEIR italics.]

The magnificent plan for Communist construction elaborated by the party opens up before the Soviet people wide and bright prospects for the *advance to communism*. Our cherished goal is close. We have to go through the *decisive stage* in the peaceful competition with capitalism and in the shortest time win

that competition. We have everything necessary to win that position. And when we have solved those problems and have cleared the way forward it will be easier for us to advance. [CEIR italics.]

These expressions, and many others, reveal the design. Powerful free world military forces must be at hand to deter realization of the design by military force. Vigorous economic expansion in the free world must be achieved to help frustrate the economic and psychological offensive, particularly against the poorer countries. The United States, and the free world as a whole, must invest heavily in the defense against the Communist offensive in all its forms.

B. THE UNDERDEVELOPED COUNTRIES: PROBLEMS AND POLICY

Disparities between the per capita income of the underdeveloped countries and the industrial countries of the free world have been widening. CEIR projections of output, taken together with population trends, indicate a further widening of these income disparities in the decade ahead. They add to the vulnerability of the underdeveloped countries.

The effort to assist the economic growth of the underdeveloped countries has been part of U.S. foreign policy for some 10 years. The financial and technical support has been notably effective in some of the countries aided. In others it has not. In all, it could have been more effective. Uncertainty has been a feature of U.S. policy and financial support. A long-term problem has been handled by a short-term approach, based on the hope that it would disappear or on the belief that it was someone else's problem, not ours. This is said in the knowledge that there are those in the Congress, the executive branch, and among the public who recognize the long-run character of this problem and its importance in foreign policy. From the policy point of view, a change is vitally needed.

The main elements in a changed approach should encompass the following points: (a) The need for external assistance is a long-term matter; (b) the industrial nations of the free world should coordinate their economic assistance efforts more fully than they are now doing; (c) the flow of capital and technical assistance should be increased from all external sources, by the end of the decade by a factor of three or four; (d) economic assistance should be coupled with expanded trade—without trade, aid can die on the vine; (e) loans for economic development should be advanced selectively, in the amounts that can be absorbed productively, to countries of strategic importance with the best chance of developmental success; (f) a common strategy on the part of the industrial, or capital exporting, countries of the free world is needed to shape the direction, type, and amount of economic assistance they will provide, each country fitting its own program, insofar as practicable, into the general strategic plan; (g) the underdeveloped countries undertaking growth programs need the assurance of a continuing, businesslike program to enable them to look ahead with hope of success for ambitious industrial plans instead of the uncertainty they now face; and (h) they in turn need to establish more fully the environment to attract capital, public and private, a condition essential to the long-run success of their programs.

A concrete, long-term program for economic development, which the United States and the Western European countries would form

as partners with the underdeveloped countries, could strengthen the community of free nations. It would offer the underdeveloped countries a realistic alternative to the poverty under which they now live.

Such a program should emphasize reasonably rapid growth with rising consumption standards. This in fact is a type of program the Soviets could not match. Their program is one of keeping down the consumption of their peoples in order to plow back everything possible into the expansion of the economy for the political purposes of the state. It is in fact a policy of growth with little consumption, as seen in mainland China, the European satellites, and the U.S.S.R. itself.

The United States and the industrial nations of Western Europe should assume the role of technical advisers, friends, and good bankers and set long-term goals of capital outflow from them to the underdeveloped countries. Every assistance should be given to these countries, as needed, in the formulation of sound, realistic, well-balanced programs. The United States should assume the initiative, in shaping a strategy, in strengthening its own economic assistance programs, in urging others to do likewise, to urge the greater coordination of the activities of the many governmental, regional, and international agencies now in this work, and to propose such additional organizations as may be needed to mobilize free world resources.

Our experience in the last 11 years in Europe has demonstrated the efficacy of bold, imaginative action. When the Marshall plan was conceived, Europe was in the throes of painful recovery from the economic disruption of World War II. The Communist threat gained strength from the seemingly hopeless outlook facing Europe. The Marshall plan provided both resources and hope, and the organized efforts of the European countries made the Marshall plan a resounding success.

A similar dramatic achievement is possible through a bold, imaginative program of economic development sponsored by the United States and the principal industrial nations of the free world. Small measures are not likely to work; a crisis is creeping up on many of the underdeveloped heavily populated countries. This must be met, for the stakes are large.

On this large, complex problem, CEIR offers a number of recommendations, some general, others specific.

A. The United States should take the initiative with the industrial nations to fashion a common strategy of economic development against the economic threat of the U.S.S.R.—an economic offensive focused on the underdeveloped countries. A common economic strategy is as essential as is a common military strategy prompted by the threat of aggression. Such an approach would define the purposes, scope, direction, types, and the allocation of economic assistance.

B. As part of its efforts in this undertaking the United States needs to revamp its aid program. The efforts to establish the Development Loan Fund on a larger and more permanent basis, with a public loan authorization, need realization. The United States is building up deposits of foreign currency through the interest payments and principal repayments under mutual security and Public Law 480 loans. These deposits will grow greatly over the next decade. They should

be channeled into the Development Loan Fund, or into the proposed subsidiary of the World Bank for development financing. Development loans of foreign currency, generated by the sale of surplus commodities, need to be more closely associated with the loan operations of the Development Loan Fund, the Export-Import Bank, and the World Bank. In its developmental efforts the United States has a number of governmental agencies lending large sums, but coordination leaves much to be desired; intergovernmental committees at several levels are not an effective means of administration. The task of coordinating U.S. Government agency programs must be linked to the larger task of coordinating the U.S. effort with those of other governments and the regional and international agencies, consistent with the strategic aim of the common effort.

C. It is recommended that an examination be undertaken to determine the necessary steps for coordination of U.S. agency operations, and, in concert with other free world industrial nations, the coordination of all capital-export activities to the underdeveloped countries.

C. ECONOMIC GROWTH IN THE UNITED STATES

This report also stresses the importance of our own economic growth to the position and strength of the United States in world affairs. It shows that economic growth can no longer be regarded merely as an economic problem; it is now also a defense and foreign policy problem. Despite this importance, growth as a clear-cut objective plays a minor part in U.S. policy. Indeed, this Government has no growth policy in a comprehensive sense.

Meanwhile, if present trends continue there will be a growth of 130 percent in the gross national product of the Soviet Union by 1970 compared with less than 70 percent in the United States. Growth seems to be a well-defined objective in Soviet policy. Soviet leaders have clearly stated their intentions to overtake and surpass the United States in production. For them, economic performance is their foundation for the "competitive" struggle between communism and the free world and particularly the United States. This challenge cannot be taken lightly, or shrugged off, despite the element of exaggeration in Soviet pronouncements. The comparison on the basis of industrial growth, and still more on the basis of nonconsumer industrial growth, is much worse. The basic fact must be faced that in the last area they might exceed the United States by 1970 even though their total gross national product will be only 55 percent of ours.

The United States must, therefore, take a close look at its growth prospects to determine which present policies and practices might inhibit expansion, and what other policies might be adopted to further the growth process.

CEIR offers the following recommendations:

1. The Congress should undertake a searching examination of the existing legislative framework to determine the impact of present policies and laws on the indigenous sources of growth. Specifically, the Congress should reexamine those policies which inhibit growth by curbing savings, restricting investment or encouraging disinvestment, boosting costs, limiting trade, and imposing unnecessary rigidities on the economy. The first step should be the removal of legislative deterrents to growth. This examination might appropriately be car-

ried out by the Joint Economic Committee, with a legislative action orientation.

2. In addition to the removal of possible deterrents to growth, Congress and the executive branch should seek new policies designed to provide incentives to increased savings on the part of the public and of corporations to provide the real and financial resources necessary for growth. Tax incentives to encourage savings should be investigated. Incentives to increased investment also need examination for possible adoption as policy measures.

3. Incentives for the encouragement of savings and investment will encounter strong opposition on the part of groups who consider savings as a "drag on purchasing power" and investment as a means of building up large personal incomes. Therefore, efforts along the lines of 1 and 2 above should be accompanied by direct, objective statements of fact and of the far-reaching issues involved in the need for rapid growth and an effective growth policy.

4. Concurrent with the examination of growth deterrents and growth incentives in legislation and public policy, it is essential that a similar examination be made of those business and labor practices which inhibit growth by (1) imposing rigidities which hinder adjustments, (2) raising costs, (3) restricting competition, (4) reducing efficiency, and (5) limiting technological change. The accommodation of short-run private and group interest to long-run growth requirements is no simple or easy matter. Honest men differ widely on this age-old problem. But an objective examination of group practices and policies by Congress and by the groups themselves is a necessary first step toward mitigation of private deterrents to economic growth.

D. COORDINATION OF DOMESTIC AND FOREIGN POLICY

Many internal policies and programs directly or indirectly affect U.S. relations with foreign governments. Measures to protect particular groups by quotas, tariffs, special government procurement policies, and related measures, are frequently enacted with insufficient weight being given to foreign policy implications. Growing international tensions seem indicated for the decade ahead, among other reasons because of Soviet designs and capabilities. For this reason, new legislative measures designed to meet internal problems must be judged by their impacts on foreign policy and the international position of the United States. A coordinated approach to internal and foreign policy issues is needed.

CEIR recommends that the Foreign Relations Committee take the lead to assure that new legislative proposals, relating to domestic affairs but which have important foreign policy implications, be considered in the light of their effects on the foreign policy and position of the United States. This might be appropriately achieved by cooperation between the Foreign Relations Committee and the Joint Economic Committee. The purpose should be to minimize conflicts between domestic policy and foreign policy, and to seek the internal policy alternatives which will achieve the desired result and be least likely to affect adversely the international position of the United States.

It is further recommended that the growing demands for the protection of domestic industries and groups be resisted except where the national defense would be clearly threatened by the loss of domestic production. Foreign competition is something to be met by the ingenuity and adaptability characteristic of American competitive enterprise. The growth of worldwide competitive markets is essential for the strength of this country and the rest of the free world and for any program of more rapid development for the underdeveloped countries.

E. THE U.S. BALANCE OF PAYMENTS AND DOMESTIC POLICY

The changed balance-of-payments position of the United States has been noted in the summary and elaborated in the report. Both the foreign and domestic policies of this country need to be evaluated in the light of their possible impacts on its balance-of-payments position should this prove a continuing problem. It is urged that this be done, by Government and private groups, on questions of fiscal policy, farm price policy, wage, cost, and price decisions by business and labor, and other policies and decisions affecting prices, costs, and productive efficiency. These matters affect the level of prices, the competitive position of American industry in world markets, and in its own market, and therefore the U.S. balance-of-payments position. The dominant element in the foreign balance is merchandise trade. In the interest of economic growth here and among our trading partners this trade needs continued expansion. In the interest of easing balance-of-payments pressures, this country needs a growing export trade.

The balance-of-payments problem may tend to raise as an issue the continuation of U.S. aid programs. Economic aid to underdeveloped countries could be arranged, if necessary, so as to have little or no deficit effect. However, the real problem is to maintain confidence in the dollar through the competitive position of U.S. exports.

It is recommended that an objective informational facility be established to lay before the public and all immediately interested parties the facts relating to costs, prices, productive efficiency, and such other matters that will affect the U.S. competitive position, and that such a facility not be limited to labor-management wage and related negotiations, but that it encompass governmental actions as well, such as surplus commodity pricing.

F. SURPLUS COMMODITY DISPOSAL

In recent years, the U.S. surplus disposal program has tended to depress world prices and to undercut, through sales for local currency, the normal markets of allied and friendly nations. While the legislation states that the program should not "unduly" affect the normal trade, the repercussions indicate that it has. It is likely that U.S. agriculture in certain lines will produce far more than is normally consumed domestically or exported. A "surplus" problem seems chronic for some time.

It is recommended that the Foreign Relations Committee, together with the Senate Agriculture Committee, reexamine the agricultural surplus disposal program from the viewpoint of its impact on foreign

relations. It is suggested that a surplus disposal program be established involving some joint arrangements with other surplus producing areas, to share both the benefits and the losses in the interest of good foreign relations.

G. COMMON STRATEGY IN INTERNATIONAL ECONOMIC RELATIONS

The growing economic strength of the Soviet Union, particularly in its industrial sector, will enable it to increase its trade and generally to participate more fully in the world economy. Based on present indications, this growing strength will be used to exploit special difficulties that might arise between the western industrial nations and the underdeveloped nations. It conceivably might be used to exploit the normal conflicts and divergencies of interest among the industrial nations of the free world. The Soviet Union mixes political considerations with its commercial requirements when this is to its advantage. It is incumbent upon the nations of the free world to guard against Soviet actions in the international economic sphere which will tend to disrupt the general unity essential to face the communist threat.

CEIR therefore recommends that the United States take the lead in fashioning, with the other industrial nations, a common strategy against any economic threat of the U.S.S.R.

Purposes to be achieved by concerted policy and action are: (1) to minimize the normal conflicts of interest that will arise among the industrial nations; (2) to mitigate conflicts of interest between the industrial nations and the underdeveloped countries; (3) if Soviet tactics warrant it, to create a joint organization for the conduct of economic warfare; and (4) to foster and strengthen an open, free market world economy for the security and strength of its members.

H. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

To sum up the conclusions and recommendations of this report:

1. The Soviet intention is to attempt to take over the world for communism, and its latest economic plans show that it is mobilizing its rapidly growing industrial strength for precisely this purpose.

2. While the income of the Soviet bloc will grow by 120 percent by 1970, that of the free world will grow by only 83 percent, and that of the United States by less than 70 percent. In industrial output, other than for consumers, the Soviet might overtake the United States before 1970.

3. Soviet cold-war efforts are now being focused increasingly on the economic arena, and they have selected as targets the underdeveloped countries and will soon have substantial capital goods production to support their campaign.

4. World population will rise rapidly (22 percent) by 1970, that of the free world underdeveloped countries by almost 30 percent. Because of this, disparities in per capita income will grow even greater between the rich and the poor countries of the free world.

5. The underdeveloped countries are stirring under a worldwide dissatisfaction with present conditions and methods, and impatience for rapid economic growth. Unless the free world can make a distinct change and create soundly based hope for rapid economic improvement, the underdeveloped countries might fall prey to the "growth without consumption" formula of the Communist system.

6. Loss of the resources of the underdeveloped countries to the Communist community would completely change the world balance of power in favor of the U.S.S.R.

7. The United States and Western Europe together have a much better system, namely "growth with consumption," as well as three times the economic wealth of the bloc. They can, therefore, if they have the wisdom and the will to act, win this contest in the underdeveloped areas.

8. This will require, however, capital investments in those areas far transcending present rates.

9. For these reasons the free world needs—

(a) To continue to promote the growth of the industrialized countries at faster rates, with coordination of efforts;

(b) To embark on a long-range free world program, concentrating on decisive growth of the underdeveloped countries under the formula of "growth with consumption," financed with long-term loans.

10. The United States must become increasingly "growth conscious", and policies and laws should be examined from the point of view of their impact on our growth. Old ones need revamping and new ones need fashioning. Domestic economic policy, from this point of view, has most important foreign policy implications.

11. Recent balance-of-payments deficits of the United States have favorable as well as unfavorable aspects. Insofar as they portend wider convertibility they will ease free world trade and payments problems. Large lending programs to the underdeveloped countries need not exacerbate the problem; if it persists, such loans could be related more closely to the export of U.S. goods.

12. Confidence in the U.S. dollar is a key factor. Sound domestic economic and financial policies, public and private, are essential to maintain stable prices and the international competitive position of U.S. goods.

13. The United States should aim at maximum liberalization of trade in the free world and set an example through the removal of its own restrictions.

14. All U.S. domestic economic and financial policies should be carefully considered from the point of view of their compatibility with our external foreign and economic policy. There should be a unity of purpose and unity of approach in our domestic and foreign economic policies.

All in all, the people of the United States and the free world need to realize that they are at an important juncture in world economic history when right decisions right across the board must be made. Basically our need is to face up realistically to our danger, and to replace our term insurance with an endowment policy. The free world has a 3 to 1 superiority over the Communist bloc in economic resources. It has greater basic assets in its "growth with consumption" philosophy and its moral and religious values. Its only handicap is that it is an assembly of many nations, all free, in a contest with a monolithic group of captive nations directed from the Kremlin. The obvious need is for the free world, first to find a way to act together, and second to act decisively enough. This is the challenge to the legislators and administrators of America today. The fate of the free world may well rest on their energy, courage, and wisdom in the years immediately ahead.

II. WORLDWIDE AND DOMESTIC ECONOMIC PROBLEMS, 1957-70

A. SUMMARY OF THE STUDY

1. The most important worldwide and domestic economic problems which will affect the foreign policy of the United States in the 1960's flow from (i) the determination of the Soviet Union to press forward unswervingly and unscrupulously with the "Marxist-Leninist" program of communizing the entire world; (ii) the rapid rate of economic and industrial growth of the Soviet bloc; and (iii) the obvious intention of the Soviet Union to make full use of this growing strength to win the underdeveloped countries of the world for communism.

2. The international economic position of the United States has undergone a change during the 1950's and present trends will produce further changes in this position during the 1960's. These have involved the strengthening of the economies of Western Europe as a region, the Soviet Union, and Japan, in relation to the position of the United States in the world economy. This is a normal consequence of the post-World War II recovery and growth of these other industrial nations. In the free world, although traditional patterns and weights among nations have been, or are being, reestablished, new patterns are forming:

a. Comparing the gross national product—the most comprehensive measure of productive activity—elsewhere with that of the United States, the evidence indicates a more rapid rate of growth per annum in the Soviet Union, Western Europe (including the United Kingdom) as a region, and Japan than in the United States during the past decade. The U.S. average growth rate approximated 4 percent per annum in the last decade. The Soviet rate has been nearly twice the U.S. average. Western Germany, other industrial centers in Europe, and Japan, have achieved about five-sixths of the Soviet growth rate during much of this period. By 1957, the Soviet gross national product had grown to about 40 and 44 percent of the outputs of the United States and Western Europe, respectively, and its industrial output to considerably greater percentages.

b. The industrial resurgence of Western Europe has brought the combined gross national products of the region to within 10 percent of that of the United States.

c. The industrial strengthening of Western Europe as a region has been accompanied by substantial improvement in its international financial position. Gold and foreign exchange (dollar) balances have increased by some \$13.5 billion in the 9 years through 1958, due mainly to the balance-of-payments deficits of the United States over this period. Foreign aid commitments and military expenditures abroad

of the United States helped greatly in both the industrial and financial strengthening of Western Europe.

d. The economic, financial, and trade recovery of Western Europe has, with few exceptions, restored this region as the dominant world trade area. This area is the best customer of the United States and also of the underdeveloped countries of the free world.

(1) As a consequence of this recovery, Western European (and Japanese) exports have become increasingly competitive with U.S. exports over a wide range of manufactured products, and to some extent in the U.S. market as well.

(2) The major European countries have become substantial capital exporters, both from private and Government sources; much of this capital is being invested selectively in underdeveloped countries.

e. Soviet bloc economic recovery, and the change in policies in the post-Stalin period, have increased bloc trade with the free world. This has been accompanied by credits and loans amounting to over \$2 billion extended to a number of underdeveloped countries, particularly in the Middle East and Asia.

(1) This participation by the Soviet bloc in trade and aid is in the nature of an economic offensive directed against the economic and political influence of the Western Powers.

(2) The chronic capital shortages in the underdeveloped economies, their anxiety to embark on much greater rates of growth to yield significant increases in their standard of living within decades instead of a century, and their psychology, make many of them receptive to offers of trade and aid from the bloc.

f. These developments in the industrial sectors of the free world and in the Communist bloc have materially altered the position of the United States in the world economy compared with its position in 1950. While this country remains the largest single producer and world trader by a substantial margin, other production centers have grown to positions of great influence and power. This trend will continue in the 1960's.

3. In projecting changes in the positions of the United States, Western Europe, and the Soviet Union over the decade of the 1960's, the following estimates, as orders of magnitude, appear reasonable:

a. U.S. gross national product, with an assumed 4-percent annual growth rate, would total about \$740 billion in 1970, up \$300 billion from 1957.

b. Soviet gross national product, with an annual growth rate of 6.5 percent, would reach nearly \$400 billion in 1970, compared with an estimated \$175 billion in 1957.

c. Western Europe's gross national product, rising at a 5.5-percent annual rate, would approximate \$800 billion in 1970, about double the 1957 total.

d. The U.S. share in estimated world production, on these projections, would decline slightly from 32 percent in 1957 to 29 percent in 1970; Western Europe's share would increase slightly to 31 percent; the Communist bloc as a whole would increase its share from 21 to 24 percent.

e. On the basis of these gross national product projections, and the growth of populations, the following changes in per capita production are indicated.

	1957	1970	Percent increase
United States.....	\$2, 570	\$3, 600	40
Western Europe.....	1, 154	2, 100	80
Soviet Union.....	858	1, 600	82

4. However, changes in the gross national product, and gross national product comparisons among countries, while useful, do not adequately measure the power position of the countries compared. This position is best gaged by the industrial base of a nation, for this is an important backstop for the military establishment and for a country's international trading position.

a. Soviet industrial production has been increasing approximately 8 percent per year since 1950, twice the U.S. growth rate of nearly 4 percent per year.

(1) The U.S. economy has displayed consumption with moderate growth and Western Europe has in the fifties achieved growth with consumption. The Soviets' greater growth rate is due to their policy of growth with little consumption. This is implemented by (a) holding down consumption to about 55 percent of gross national product in contrast to 75 percent in the United States, (b) the resulting investment of a larger fraction of the gross national product; about 27 percent in the U.S.S.R. as against 17 percent in the United States, and (c) the Soviet concentration of its investment on expansion of capital goods production for industry, in order to obtain still greater expansion of production.

(2) About one-half of Soviet investment goes into industry, and about 85 percent of this into the capital goods sector of industry to the neglect of consumer industries and consumer living standards.

(3) The emphasis on industrial expansion and the military establishment is seen in the fact that only 27 percent of Soviet industrial output is devoted to consumer goods. Some 30 years ago 60 percent of output was in the form of consumption goods.

(4) In 1956 Soviet production of industrial equipment equaled 65 percent of such production in the United States. Total industrial capacity came to 40 percent of the U.S. total; 30 years ago it was only 8 percent.

b. Projecting recent rates of industrial growth, Soviet industrial output is likely to grow 9 percent per annum, and by 1970 will approximate the present volume of U.S. industrial output. It is likely to equal 60 percent of the 1970 industrial output of the United States. At that time the Soviet Union will probably exceed U.S. output of industrial equipment.

c. The Soviet industrial sector is thus growing at approximately twice the annual rate of the United States, and the projected expansions show nearly the same difference in growth rates.

(1) The basic reason for the past and projected difference in growth rates is the Soviet concentration of new capital investment in industry, particularly in the capital goods sector, i.e., in investment for industrial expansion, and little for consumption.

(2) In terms of productivity changes over time, the Soviet experience seems to approximate U.S. productivity growth rates.

(3) But comparing present industrial labor productivity, output per man-hour in Soviet industry is considerably less than half that of the United States.

d. By 1970 the Soviet is likely to be a formidable industrial nation, relatively stronger than at present, and, in certain sectors, larger than the United States.

(1) By U.S. standards—based on production for the consumer—their industrial sector will be unbalanced, but this is in accordance with Soviet plans.

(2) Given their emphasis on the capital goods sector, it is probable that Soviet exports will grow substantially as will their need for imports.

(3) Soviet military capability will be greatly enhanced by the projected expansion of their industrial base.

5. Growth is not an automatic process. United States economic expansion could be slowed, or speeded up, depending on circumstances, opportunities, and, most of all, Government policies. Reasonable stability in prices and costs, in relation to prices and costs in the other production centers, is essential for growth in a free world economy. Price and cost reductions would speed the process by increasing the competitive capability of the United States in the world economy. Domestic policies and practices which affect prices, costs, the accumulation of capital, savings and investment incentives, and the ability to shift and adjust resources to new situations, have important foreign policy implications.

6. Economic expansion here and in the other industrial centers is important to the trade and growth prospects of the underdeveloped countries. The position of these countries is difficult, and for many, their problems are likely to grow more serious.

a. Population pressure is mounting rapidly in many of these countries, particularly in Asia and in the Caribbean area.

b. During the 1960's, world population is expected to increase from 2.9 to 3.5 billion, or by 600 million persons. During the rest of this century, population is expected to more than double, reaching 6 billion by the year 2000.

c. Most of this growth will be in the presently underdeveloped parts of the world; the most rapid growth rate is expected in Latin America.

d. Population projections in the underdeveloped countries highlight the growing need for capital, for technical assistance in the industrial and agricultural arts, and for trade.

(1) Internal capital sources in the countries with low per capita income are not likely to allow for much, and in some cases for no, increase in per capita income. It will take between 5 and 8 percent of the income in poor countries for investment merely to maintain their growing populations at present consumption standards. Saving rates in excess of the 5-to-8 percent range are difficult to achieve in subsistence-income countries.

(2) Given the upsurge of population, these countries will need larger increments of capital per annum from all sources over the next 10 years than in the past 10 years in order to increase per capita production and consumption. Capital exports from private sources, governments, and international agencies have been approximating \$8 billion annually. In general, private investment is channeled into developed areas, rapidly growing areas, or in the petroleum and mineral producing parts of the underdeveloped world. If private capital is to enter the most backward areas, special (not across-the-board) incentives seem necessary. Our study indicates that to be meaningful for the growth problem of the underdeveloped countries, the rate of total capital inflow will have to be stepped up by the order of magnitude of 100 percent in the 1960's.

(3) Substantial improvements in production techniques are needed to supplement the capital imports of the underdeveloped countries. Automation, air-conditioning and atomic energy may prove especially important for such areas.

(4) As trading nations, the underdeveloped countries are primarily exporters of industrial raw materials and foodstuffs. Western Europe purchases some 60 percent of these products; the United States buys most of the rest. The Soviet Union and the Communist bloc are relatively small importers of these primary products, but trade is increasing; the bloc can become a significant market for these products over the next 10 years. It can, by concentrating on particular targets, become a very important factor in some key underdeveloped countries.

(5) Countries whose principal exports are agricultural products will, in general, find their exports growing at a slower rate than world trade. The mineral and petroleum exporters, however, will probably increase their exports in relation to world trade. Rapid industrialization in many cases must supplement trade to achieve vigorous growth.

(6) The United States is becoming increasingly dependent on imported ores, minerals, petroleum, and other materials. Largely for this reason, U.S. imports may rise in relation to our gross national product.

e. The prospects of growth in the underdeveloped countries depend partly on their trade prospects, and these in turn depend on the rates of economic growth in the industrial countries. Trade prospects differ, depending on the types of exports. Trade policies in the industrial nations will also govern the volume of trade and types of trade. Restrictionist import policies in Western Europe and the United States are currently factors which inhibit trade and growth in the underdeveloped countries. Such policies tend to divide the free world and to improve the outlook for expanded Soviet trade and influence in the underdeveloped countries.

f. Growth prospects in the industrial countries of the non-Communist world are to a considerable degree dependent upon even greater access to the essential primary commodities of the less-developed countries. By increasing the cost of raw materials, restrictionist policies are likely to retard rates of expansion in the industrial nations. Moreover, because they reduce the markets for industrial ex-

ports to the underdeveloped countries, they also retard the rate of growth of the industrialized countries.

7. Special importance must be attached to the competition in economic performance between India and Communist China. India's development efforts are made within a democratic framework of "growth with consumption" and China's in the Communist authoritarian pattern of "growth with little consumption." The rival systems are thus operating side-by-side, for all Asia and the world to observe and judge.

While the statistical evidence is far from complete, there is enough available to indicate the performance of these two large, populous countries under their different programs. During much of the 1950's, China apparently has registered the greater gains (*a*) in gross national product, (*b*) in growth rates of saving and investment and, (*c*) in total investment. While India has grown less rapidly in terms of gross national product (3.5 percent average annual rate as against perhaps three times this for China), consumer goods production has increased faster in India than in Communist China.

Some 90 percent of India's output of goods and services and 60 percent of its annual investment in industry is private. Thus it is more responsive to markets and consumer demand. In China the Government dominates the economy and forces a greater rate of savings and investment than in India—directing this investment selectively to get quick growth results. This is typical of the Communist pattern. It achieves rapid growth and a mean level of living for the people, who thus pay the price.

In some measure, the past growth performance of China simply reflects the resumption of productive activity previously disrupted. Future growth rates will, therefore, be different and the disparity between Indian and Chinese growth rates is likely to narrow in the decade ahead. This depends largely on India's ability to acquire and attract external capital. Its internal sources are severely limited by low per capita income. Complicating the Indian problem, as in China, is the growth in population, which holds down per capita income while increasing the need for capital. Within the decade the great issue posed by the rival methods of growth in these two Asian countries will be in good part decided by the willingness and ability of western industrial nations to assist the Indian effort compared with that of the Soviet Union to invest large amounts of its capital goods output in China.

8. Substantial variations are found among the Latin American countries. All are found on the lower range of the international income scale but conditions and prospects differ. Some are overpopulated; others need more people. Some are rich in natural resources; others are not. Differences in climate, topography, accessibility to markets and external resources, and in economic, social, and political institutions and attitudes are pronounced. In varying degrees, all are short of capital, of entrepreneurial ability, and of the political conditions conducive to economic growth. All are heavily dependent on foreign markets for the sale of basic commodities—their main source of foreign exchange—and on foreign sources for manufactured goods, particularly capital goods.

Under favorable circumstances growth rates in the principal Latin American countries could match or exceed those projected for the principal industrial nations over the next decade. Their population is growing at a faster rate than any other continental area. Both space and natural resources can accommodate greater growth, provided the essential capital is accumulated through domestic savings and through inducements to foreign investors, public and private. Capital imports have come mainly from private foreign investors. U.S. Government, other foreign government, and World Bank investments have been substantial, but uncertain in flow. When in operation, the Inter-American Development Bank will be an additional source of capital for the promotion of economic growth. To fulfill the promise and to develop the potential, all these sources of capital must be augmented, together with the indigenous sources of capital. But capital must be attracted by the environment to which it flows and it is essential that the Latin American governments do all in their power to assure internal political and economic stability.

9. As already noted, the position of the United States has changed with the resurgence of production in Western Europe, Japan, and the Soviet Union. Probable trends indicate these other production centers will continue to gain absolute and relative weight in the international economy. The industrial resurgence of Western Europe and Japan has been fostered by U.S. policy, specifically by foreign aid. The success of this policy of strengthening the free world industrial nations against the threat of communism is altering the position of the United States in the world economy. This has brought an easing of some U.S. policy problems.

a. Foreign economic aid to the industrial nations is no longer necessary.

b. The industrial and financial strength of the industrial nations of the free world gives them a growing capability to support common free world efforts to strengthen its vulnerable sectors, through capital exports, technical assistance, and trade.

c. Growth in production, capital exports, and trade in the West European economy can be a most important factor in the free world's competition with the Soviet bloc.

d. The United States must be alert to continue its past policy successes by further strengthening itself and the rest of the free world through the liberalization of trade and by fostering vigorous growth and flexibility in the economy. This reduces the possibility of future crises and the need for crash programs to meet problems that could have been headed off by long-term programs.

10. The position of Japan merits special attention in U.S. foreign policy. As an industrial, crowded country, Japan must trade to survive. Raw material imports and manufactured exports dominate the pattern of its trade. The Chinese mainland is complementary to the economy of Japan in important sectors; it is a potential source of coal, iron ore, and other raw materials as well as a market for Japanese industrial exports. If restrictionist policies in the United States and in other free world countries curb Japanese exports to the West, such policies are likely to give much more strength to those in Japan who feel a rapprochement between Japan and Communist China is Japan's only long-term salvation. This issue is growing

in Japan; her foreign trade problems are inevitably building up. Should this become a crisis through Western trade restrictionism, the United States would have a foreign policy crisis of the first magnitude on its hands. Japan is an important source of industrial production, an example of the growth possible in the underdeveloped countries. The free world should not find it difficult to allow her to play a most important role in a free world-wide program of economic development.

11. The position of the United States in the world economy has recently changed in other respects, namely the balance-of-payments deficit and a loss of gold. Such problems are familiar to the rest of the world; they are not to the United States. For the past 25 years the dollar has been in short supply throughout the world; the dramatic dollar shortage of the post-World War II period underscores this point. This has now changed so far as the major industrial nations are concerned and has both disadvantages and advantages.

a. U.S. foreign aid, as one component of the balance of payments, has contributed to a U.S. balance-of-payments deficit, amounting to \$13.5 billion over the past 9 years.

b. This deficit has added approximately \$9 billion to foreign balances in the United States, mainly of Western Europe; another \$4 billion was withdrawn in gold. Such acquisitions of gold have greatly strengthened the economic position of the free world.

c. A continued U.S. balance-of-payments deficit will either (*a*) increase foreign holdings of dollar balances or (*b*) cause further losses of gold. Which alternative, or combination of alternatives, occurs depends on the views and policies of foreign governments and the distribution of the deficit. Their decisions depend mainly on the confidence they hold in the future of the dollar. Our problems in Western Europe will thus depend on our success in pursuing economic policies and foreign policies which will sustain their confidence in the dollar, and lead them to hold more dollars. The extent of U.S. economic growth and stability will greatly influence the actions of foreign governments on this matter.

d. Among other things, the balance of payments depends on the future trends in U.S. exports and imports—the principal components of this country's international transactions.

(1) U.S. exports have faced increased competition from European and Japanese exports. The U.S. share in manufactured exports has declined in recent years as other industrial nations have recaptured old markets or penetrated into new ones.

(2) The Common Market is expected to affect adversely some U.S. exports to that area. In anticipation of this, many U.S. firms are planning to establish subsidiaries in the Common Market. The drop in specific exports and increased U.S. investment abroad will create balance-of-payments pressures. Offsetting this is the likelihood that increased prosperity in the Common Market will make it a growing market for U.S. exports in general.

(3) U.S. exports to the underdeveloped countries will increase as these countries grow. The extent of this increase will depend on (*a*) United States and other capital investment in those countries; (*b*) United States and other country imports of the prod-

ucts of the underdeveloped countries; and (c) the competitive position of U.S. exports vis-a-vis the exports of other industrial nations.

(4) U.S. imports will grow with the rise in the U.S. gross national product, and possibly more than proportionately, as already indicated.

(5) Both U.S. imports and exports will rise substantially in the decade ahead. The relationship between them is the decisive point. On balance, it seems more probable that the ratio of imports to exports will increase rather than hold its own or decrease.

(6) Given the present U.S. foreign policy commitments, and the probable future import-export relationship, a balance-of-payments deficit is likely to continue for some years.

(7) Given the probable increase in world trade—about 4 percent or more per annum—foreign nations can be expected to add to their foreign exchange balances, to maintain liquidity. Thus, if we can maintain confidence in the dollar, some long-term increase in the demand for dollars can be expected to absorb dollars generated by the prospective deficit.

e. Caution should be exercised in extrapolating U.S. balance-of-payments deficits into the future, and in drawing hasty conclusions as to its inhibiting effect on U.S. foreign aid programs. With respect to the latter:

(1) Insofar as the new balance-of-payments situation leads to a wider convertibility of currencies, problems of our obtaining repayment of loans we make in dollars are greatly eased. Loans made to underdeveloped countries can be repaid by them with any exports they make, not only, as in the days of the "dollar shortage," with exports to the dollar area.

(2) Insofar as Western Europe runs a payments surplus with the United States and builds up dollar balances, these countries are, in effect, lending to the United States. This opens up the important possibility of the United States becoming a "good banker" to the underdeveloped countries, lending to them while borrowing from Western Europe.

(3) Aid to the underdeveloped countries could be insulated if necessary from the balance of payments by tying assistance to U.S. exports. Then exports would increase *pari passu* with the lending program. This alternative has some disadvantages and should be considered only as a last resort.

12. The changing international environment comes at a time when Soviet economic capability is growing. These facts suggest the need for a common long-term strategy on the part of the free world to mobilize its immense resources against the common threat and decisively win the cold war in the economic arena. Together, the nations of the free world hold a vast economic margin over the Communist bloc—in economic resources, in trade and financial connections, in technical developments, and in experience. These advantages can be dissipated through divisive policies; they can be strengthened by concerted efforts in countering the Communist threat. All we really need is courage, flexibility, imagination, and the will to act decisively.

B. INTRODUCTION

This report considers a number of major economic developments and difficulties which are likely to alter the international economic environment of the United States during the course of the 1960's and will present challenges to the adaptability and effectiveness of both domestic and foreign U.S. policy. Indeed, as will be emphasized throughout, these two areas of national policy are now completely intertwined. Increasingly, domestic policy is influencing, and should be influenced by, our international political and economic problems. As the international environment changes, it is vital that domestic policies and developments be formulated with much greater regard to their effects on our national interests in the international sphere, especially on our ability to win the cold war.

Among the major developments which can be traced through the next decade, the following stand out: (1) The Soviet Union and the Communist bloc will continue to grow in economic strength much more rapidly than the free world, and their capability of implementing their announced intention of winning the world for communism will become ever more formidable; (2) Western Europe as a region gives promise of expanding its industrial growth and trading activities at a rate only slightly lower than that of the Soviet bloc and of assuming more of the burden of waging the cold war; (3) industrial growth in the United States is expected to be much slower, though still exceeding somewhat the historical trend for this country; (4) the aspirations of the underdeveloped regions to grow more rapidly economically will become ever more clamorous and must be faced, but their rates of growth and consumption will depend heavily on extension of trade with the industrial nations and on increased amounts of long-term capital investment available from those nations.

From this vantage point, the 1960's will not be an easy decade for those responsible for U.S. foreign policy. The economic offensive of the Communist bloc seems likely to accelerate with the bloc's economic strength. This is a threat to the United States and the free world as a whole, and particularly to the peace of mind of the underdeveloped countries which are very vulnerable politically to the Soviet psychological warfare. Meanwhile, some tensions are likely to arise within the free world due to the growing competition for markets among the industrial nations, and to the great trade and capital requirements of the developing countries. Trade restrictions and discriminations in any area of the free world can weaken the cohesiveness of the free world as well as inhibit its economic growth. In the interest of U.S. national security and the security of the free world, it is of utmost importance that those responsible for foreign policy take measures to minimize such tensions.

A new element is emerging so far as the United States and its position in world affairs are concerned. The dollar has recently become much less a "hard" currency. Our freedom of action, our capacity to undertake foreign commitments, may be affected by this fact. The extreme hardness of the dollar in the past vastly complicated trading and payments problems for the rest of the world. Not only did trade and payments as a whole have to be considered, but dollar trade and payments had become a difficult separate problem. Insofar as recent

changes portend a wider convertibility of currencies, these problems will be greatly eased. The creditworthiness of the rest of the world, and especially of the underdeveloped countries, for loans in U.S. dollars, will be enhanced. If we ourselves are running an overall balance-of-payments deficit, the only real problem is whether there is confidence in the dollar, or whether such a deficit leads to a drain on our gold reserves. If there is confidence in the dollar, we shall, in effect, be simultaneously borrowing from the developed countries of the free world while lending to the underdeveloped countries. We shall, in effect, become a good banker—with depositors as well as borrowers—helping finance economic development. If there is a loss of gold, however, the depositors will, in effect, be withdrawing their deposits and we shall be forced to tie to the purchase of U.S. goods the loans we make to underdeveloped countries.

Thus, our payments problem should not disturb us if we are prepared, psychologically, to become investment banker to the underdeveloped countries. Our balance of payments will, of course, be influenced by internal developments, such as wage, cost, and price trends, by fiscal policy and monetary policies, and by our rate of economic expansion. Depending on these internal developments, and our attitudes toward our emerging new external position, we can either gain by these new developments or, if we act unwisely, we can be seriously inhibited by them. These issues are considered later in this report.

Our report devotes considerable attention to the changing economic position of the Soviet Union, its growing economic capability, and its probable courses of action in the international economic arena. That is not to say that the cold war of the U.S.S.R. will generate all the economic problems lying ahead in the 1960's. Even if the Soviet threat vanished in internal confusion and collapse, there would remain problems enough in the international economic sphere. But the presence of the U.S.S.R. with huge resources, central planning, and its malevolent design to devote its resources not to the good of its own people but to world domination, adds materially to the complexity and dangers of the decade ahead.

Among other things, this report assumes no abatement of the cold war and the military burdens it imposes on all parties. It assumes that the cold, calculating minds of the Kremlin will act rationally and not precipitate a world nuclear war which would destroy the entire U.S.S.R. and large parts of the free world. It assumes that the free world is successful in preventing further extension of the geographic limits of the Communist bloc, both on our perimeter and in the underdeveloped countries in the heart of the free world. It assumes an intensification of the bloc's economic offensive as its economic capability grows.

In this uneasy context, the report holds that the national interest of the United States requires (a) a definite policy of economic growth, with financial stability in this country; (b) the continued strengthening of the economic position of our allies among the developed countries of the free world; (c) the liberalization of international trade, as essential to free world strength and cohesiveness; (d) a bold, new, ambitious program by the free world to set in motion much more rapid "growth with consumption" in the underdeveloped countries

through cooperative long-range economic development programs for the whole free world; and (e) clear, consistent, long-term U.S. policies, implemented with fresh, imaginative methods, in the conduct of international relations in furtherance of the above objectives. Provided we recognize our problems clearly, the free world has tremendous superiority in economic, moral, and religious resources over the Soviet bloc. We can be supremely confident of decisively winning the cold war in a decade, provided we are willing to act decisively. All we need fear are ignorance, apathy, selfishness of particular economic groups, preoccupation with high living, lack of courage, and, above all, lack of leadership for the Nation and the free world.

CHAPTER I

ECONOMIC GROWTH TRENDS IN THE UNITED STATES, THE U.S.S.R., AND OTHER REGIONS

I. PROSPECTIVE INCREASES IN GROSS NATIONAL PRODUCT

A. INTRODUCTION

A projection of the growth rates of production (gross national product) for the United States, its allies, the Soviet Union and its captive coalition, and other regions, is a necessary preliminary step in assessing the future relative positions of the major countries and regions. Such projections are given in this section from the base year, 1957 to 1970. Average annual growth rates are assumed to range from 4 percent for the United States to 6.5 percent for the Soviet Union, with the Western Europe growth rate in between.

The United States presently enjoys better than a 2 to 1 superiority over the Soviet Union in gross national product. This ratio will decline somewhat between now and 1970. Estimates of gross national product are useful indications of general economic capacity, but are not decisive in comparing military strength, international economic position, or political influence. These depend on to what national policy purposes the gross national product is devoted. The United Kingdom's gross national product is considerably less than that of the Soviet Union, yet the British international economic weight much exceeds that of the U.S.S.R. While there is no unique relationship between gross national product and a nation's position in international affairs, it is no coincidence that the two leading military powers are also the two leading industrial nations. And no country can be a major element in international economic affairs today without a sizable industrial base.

A number of limitations should be kept in mind in making international comparisons of present and projected gross national product estimates. In general, gross national product measurements tend seriously to underestimate the gross national product in poor countries relatively to wealthier countries. One of the principal reasons is the low valuation placed on personal services, and on service industries and professions generally.

The estimates by countries vary greatly in reliability. Those of the Western industrial nations are based solidly on copious statistical series; for others, the paucity of data injects a good deal of guesswork into the national accounts.

In the less-developed countries, a considerable amount of consumption and capital accumulation goes on outside the market system. These must be estimated; and such estimates are subject to a wide margin of error. Any shift in nonmarket to market activity, which

normally accompanies development, will tend to overstate growth rates over a period of time.

Special problems arise in connection with the Soviet estimates. The official estimates of the Soviet Union exclude services rendered to consumers, rental and interest income, and general Government services; they are not considered productive services. Accordingly these must be estimated to obtain reasonable comparability with other gross national product estimates. Moreover, the statistical weights assigned to, say, the agricultural and industrial sectors in the Soviet accounts may undestate or overstate growth rates. A shift in base years will produce different growth rates using the same statistical series. This is a problem common to all estimates, but in the Soviet case it is especially troublesome.

The conversion of data in foreign monetary units into dollars for purposes of comparison introduces another kind of error. The per capita income figures of the poor countries, when stated in dollars, are too low; this helps explain why people remain alive in a country with a \$50 per capita income per year. These and still other technical problems caution against too literal an acceptance of intercountry estimates of income and output. At best, the estimates indicate orders of magnitude.

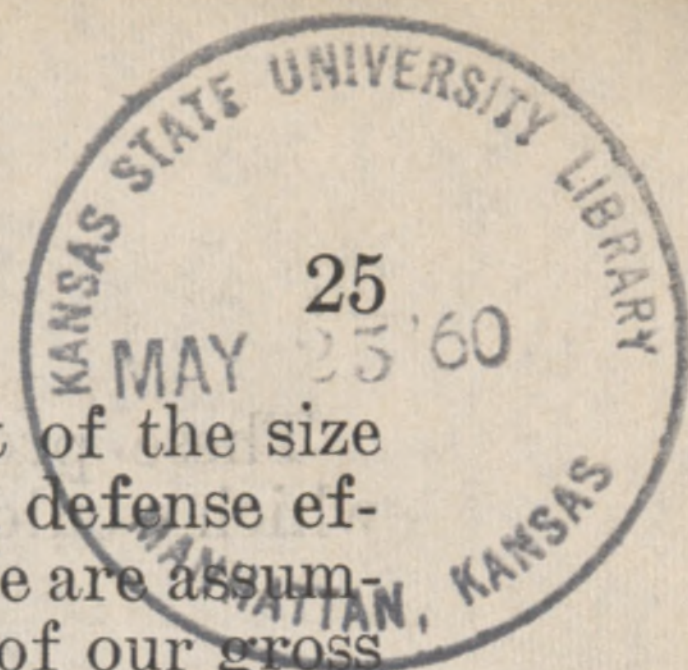
Even if the technical difficulties in compiling gross national product totals were surmounted, another caution would be in order. The components that make up the totals may be materially different, country by country. Sector differences may be more important than the totals themselves. The industrial component, including construction and freight transportation, is a larger percentage of the Soviet gross national product than it is of the U.S. gross national product. This is also true of the fraction of industrial output comprising capital goods, which are the bulk of the Soviet industrial production but only about a fifth of the U.S. industrial output.

There are also substantial differences in the uses to which the capacity to produce is applied. About 75 percent of U.S. gross national product goes into consumption channels in contrast to about 55 percent in the U.S.S.R. The end uses of gross national product, moreover, shape the direction and types of investment. In consequence, a larger fraction of the U.S. investment supports further expansion of consumption than in the Soviet Union. Therefore, a given amount of investment in the U.S.S.R. and in the United States will have different long-range growth effects.

These contrasts in components and end uses partly offset differences in the magnitudes of the gross national products. The Soviets devote a larger portion of their industrial output to growth and to their military establishments than does the United States. On the other hand, the vastly larger U.S. gross national product gives us potentially far more disposable resources for emergencies than the Soviets can muster.

B. GROSS NATIONAL PRODUCT PROJECTIONS: UNITED STATES

With 1957 as the base year for projection purposes, CEIR's estimate for U.S. gross national product in 1970 is \$740 billion. This is an increase of \$300 billion, or 68 percent, over the 1957 total of \$440 billion, measured in 1957 dollars (prices).



Much depends upon assumptions, especially in respect of the size of our defense effort over these years. Any reduction in defense effort would increase our rate of growth and vice versa. We are assuming here that we continue to devote the same percentage of our gross national product to defense during these 13 years as in recent years—that is, a rising absolute amount in dollars.

This estimate assumes a 4 percent average annual rate of growth for the years 1957–70. There are numerous estimates of future U.S. economic growth, ranging from a low of 2 percent per annum to as high as 5 percent per annum. But over the decades for which satisfactory data are available, this country has never maintained for long a rate of growth as low as 2 percent per annum, nor one as high as 5 percent.

Over the last 70 years (1887–1957), the average annual growth rate was 3.5 percent, according to estimates of the National Bureau of Economic Research.¹ This long-term growth rate accelerated somewhat during 1947–57, averaging 4 percent per annum, despite the fact that the military program withdrew a sizable number from civilian work during and following the Korean war. Economic growth depends upon improvements in productivity and an increase in labor and capital. During the 1960's, the labor force will grow annually by much larger increments than during the 1950's—an estimated 1.2 million in contrast to less than 800,000. Because of this, and assuming high levels of investment and employment, and continued productivity improvements, an annual growth rate of 5 percent is possible. Under the most favorable circumstances, the rate could go even higher.

The low estimate of 2 percent per annum is considered by CEIR to be unrealistic. Mr. Khrushchev has selected this prediction. It assumes substantial and chronic unemployment during the 1960's, or alternatively a reduction in average hours worked per week. Both would be at the expense of economic growth and therefore contrary to national interest. Neither seems probable in view of the worldwide upsurge in population, in technological accomplishments, in consumption requirements, and in the need for capital.

The CEIR estimate of an average annual gross national product growth rate of 4 percent is reasonable, possibly conservative. It implies a gross national product of \$740 billion in 1970, with civilian employment approximating 77 million persons. It is estimated that some 83 million will be in the labor force, with military forces unchanged from present levels.

The principal projections are shown in the following tabulation, 1970 contrasted with 1957:

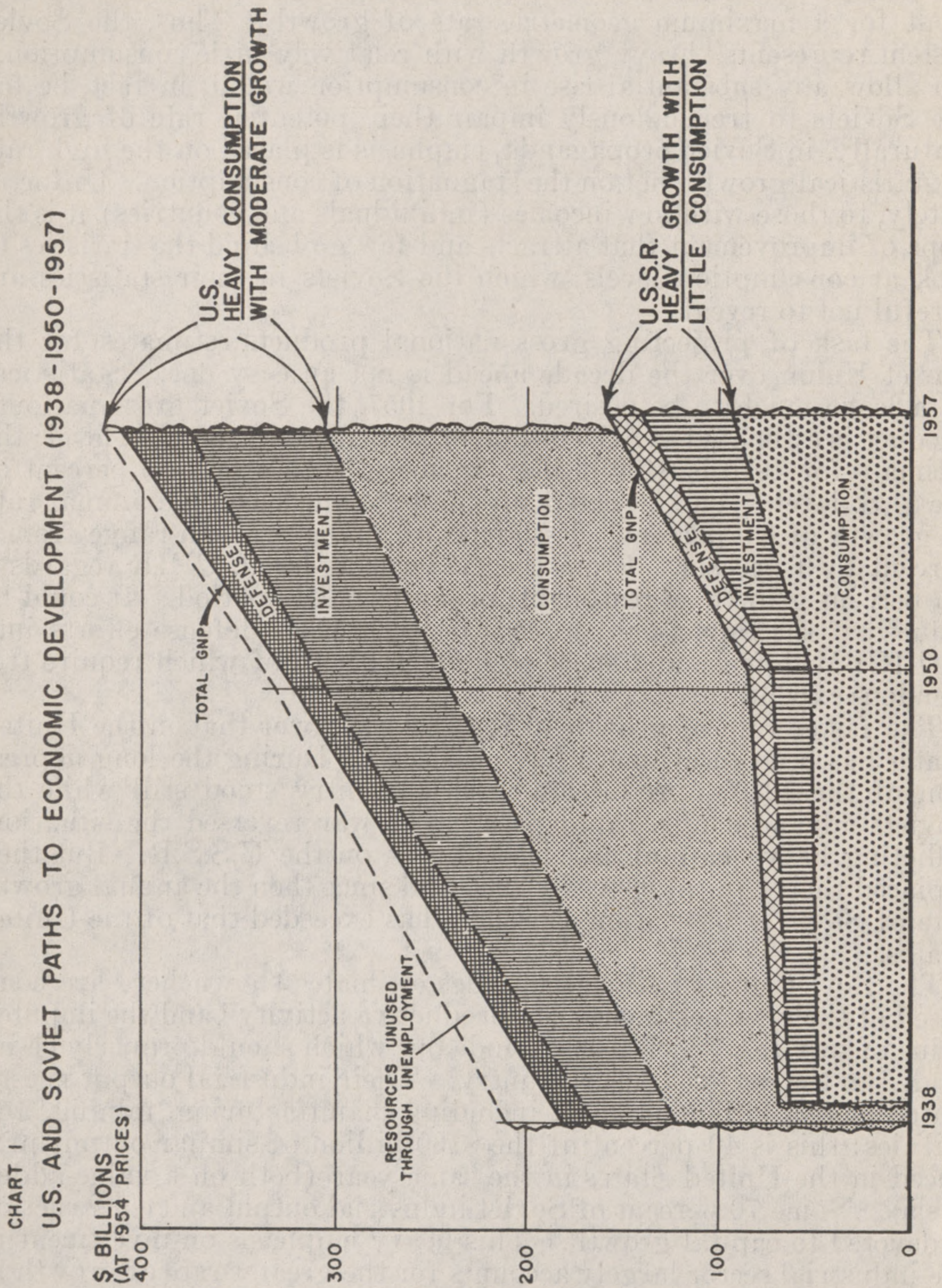
United States	1957	1970
Gross national product.....	\$440,000,000,000	\$740,000,000,000
Population.....	171,000,000	204,000,000
Labor force.....	70,700,000	83,500,000
Per capita gross national product.....	\$2,570	\$3,600

¹ See also statement of Raymond W. Goldsmith: "National Product and Income: Long-Term Trends," before the Joint Economic Committee, Apr. 7, 1959, for estimates back to 1839.

These projections rest on a host of assumptions, modification of which would, of course, produce different results.

C. GROSS NATIONAL PRODUCT PROJECTION : U.S.S.R.

It might be useful at the outset to point out that the United States and the U.S.S.R. pursue two quite different ways of life economically. Under the U.S. system of free enterprise the economy implements consumers' demands and expands, fundamentally, only as fast as the voluntary savings and investment of the population will support growth. The U.S. way of life is "heavy consumption with moderate growth;" our savings are, relatively, among the lowest per dollar of income of any of the world's industrialized countries. (See chart 1.)



At the other extreme, the Soviet way of life is centrally planned to implement national objectives, and the desires of its citizens for consumption are given short shrift, even in times past to the point of mass starvation. Consumption is, in fact, kept down to the maximum extent politically possible—which under a strong dictatorship is very far indeed—to enable all resources to be ploughed back into investment for a maximum geometric rate of growth. Thus, the Soviet system represents “heavy growth with relatively little consumption.” To allow any substantial rise in consumption would, in fact, be for the Soviets to tremendously impair their potential rate of growth. Naturally, in Soviet propaganda, emphasis is placed on the high rate of statistical growth, not on the stagnation of consumption. Unfortunately, to those with low incomes (individuals and countries) it is the hope of improvement that attracts and few go behind the statistics to look at consumption levels, which the Soviets in their statistics are careful not to reveal.

The task of projecting gross national products estimates for the Soviet Union over the decade ahead is not an easy one. Statistical data leave much to be desired. For 1957, the Soviet gross national product is estimated at \$175 billion or 40 percent of the U.S. level; the estimate for 1970 is \$400 billion, an increase to nearly 55 percent of the U.S. level. This is based upon an assumed average annual rate of growth of 6.5 percent. Estimates of annual growth range from 5 percent to 9 percent. From the evidence at hand, CEIR regards a 6.5 percent growth as reasonable over this entire period. It could be reduced if the Soviets are forced to divert their defense efforts into anti-ICBM defense and space technology, both of which require tremendous expenditures.

The faster rate of growth in the U.S.S.R. over that in the United States has been in evidence for some time. During the long depression of the 1930's, production in this country stood still while the Soviets advanced at a rapid pace. The war reversed the situation, inflicting heavy capital and labor losses on the U.S.S.R. But they replaced their capital losses by 1950 and since then the annual growth rate of Soviet gross national product has exceeded that of the United States.

The Soviet gross national product estimates shown here are composed of their own estimates of “productive activity” and the imputed value of services, which they exclude but which should properly be included in the output of any country. Their industrial output is estimated at \$65 billion in 1957, including manufacturing, mining, and utilities; this is 40 percent of the \$160 billion of similar output produced in the United States in the same year (both on a value-added basis). Some 70 percent of Soviet industrial output and construction is devoted to capital growth. This heavy emphasis on investment in the industrial sector largely accounts for the greater rate of growth in the Soviet gross national product when compared with the United States.

Since 1950, Soviet industrial output has grown about 9 percent per annum; in the United States the growth rate has averaged somewhat less than 4 percent per year. Their industrial output is heavily weighted by capital goods; in the United States, consumer goods dominate the industrial component.

The present Soviet plan calls for continued high rates of capital growth. Their planned growth rates through 1965 are:

	Percent
Industrial output.....	8.8
Capital goods output.....	9.2
Consumer goods output.....	7.1
National income.....	7.2

Based on recent performance, these seem realistic projections. But many of the pronouncements made by Mr. Khrushchev regarding the Soviet Union and the United States are unrealistic and seem designed purely for internal consumption and for propaganda purposes in the underdeveloped countries. Discussing the growth rates in the present plan, he said these—

will enable our country in the course of approximately 5 years after 1965 to catch up with and to surpass the per capita output level in the United States. So by that time, and possibly even earlier, the Soviet Union will gain first place in the world both as regards the absolute output and the output of goods per capita, which will insure for the population the highest living standard in the world. That will be the world historic victory of socialism in its peaceful competition with capitalism.

If the estimates in this report are reasonably accurate, the projected 1970 Soviet gross national product will even fall short of the 1957 gross national output of the United States, and far short of our 1970 output (\$400 billion for the U.S.S.R. as against \$740 billion for the United States). In the industrial sector, however, the gap will be considerably narrowed. Assuming the Soviets maintain an industrial growth rate of 9 percent, their 1970 output will approximate the 1957 U.S. industrial production. If the United States maintains an industrial growth rate of about 4 percent per year, Soviet industrial production in 1970 will equal some 60 percent of U.S. industrial production for that year, compared to 40 percent in 1957. However, if we exclude consumer goods such as automobiles, refrigerators, washing machines, TV, and so forth, they will probably have actually exceeded the United States by that date.

Contrary to Mr. Khrushchev's prediction, the CEIR 1970 projection for per capita gross national product shows \$3,600 for the United States and only \$1,600 for the U.S.S.R. Moreover, the latter will be well below the projected West European per capita output of \$2,100. The "world-historic victory" Mr. Khrushchev anticipates lies, if at all, in the more distant future. The Soviet people can expect relatively little amelioration of their standard of living, given the uses made of their gross national product by the U.S.S.R.

Summary data on the CEIR projections for the U.S.S.R. are given below:²

U.S.S.R.	1957	1970
Gross national product.....	\$175,000,000,000	\$400,000,000,000
Population.....	204,000,000	254,000,000
Labor force.....	89,000,000	109,000,000
Per capita gross national product.....	\$858	\$1,570

It must be stressed again that gross national product projections rest on many assumptions which, however reasonable, are necessarily

² The projected increase in gross national product assumes an annual 5-percent improvement in productivity.

arbitrary. The Soviets might better the mark set forth in the CEIR projections. And they could fall short. They face serious labor shortages due to low birth rates during World War II. On the other hand, their stress on technical training and automation may pay off in unexpected increases in productivity. Their agricultural sector is a weak element in their system, and industrial obsolescence may become a drag on their industrial advance. But these potential drawbacks may not make their effects felt in the period under consideration, or might be overcome by greater effort. In any case, the outlook for the free world is grim. The Soviets show no signs of abandoning their determination to use every expansion of their capability largely for purposes of pursuing their aggressive aims. If they approximate the projections here set forth—an expansion of almost 130 percent compared with less than 70 percent for the United States—they will have an economic capability adequate to support all manner of troublesome military and economic warfare ventures.

D. GROSS NATIONAL PRODUCT PROJECTIONS: WESTERN EUROPE

Since the early 1950's Western Europe³ has made an impressive economic record. In 1957 its aggregate output nearly equaled that of the United States and was more than double that of the Soviet Union. Annual rates of growth in West Germany, France, and Italy have approached or equaled those of the U.S.S.R. This European performance is more than a revival or a recovery from the devastating effects of World War II—it has the appearance of a dynamic, buoyant expansion of productive power. Recovery was the purpose of the Marshall plan, but European enterprise, industry, and skill have not only made it a resounding success, they have done more. Revitalization of this dominant industrial, trading, and financial region is a development of great importance, too often overlooked in the preoccupation with Soviet economic growth.

In 1957, gross national product in Western Europe aggregated \$397 billion, within 10 percent of the U.S. total. CEIR projections to 1970 raise this total to approximately \$800 billion, somewhat larger than the projected total for the United States and still twice the projected Soviet total for 1970. This is an expansion of over 100 percent compared with the Soviet 130 percent.

³ For purposes of this report, "Western Europe" covers all European countries outside the Communist bloc, ranging from Greece and Turkey to the Scandinavian countries, including the United Kingdom and Ireland.

The estimate assumes a 5.5 percent average annual rate of growth. This, of course, may prove too high, especially if, as incomes rise, the U.S. pattern of a low rate of saving manifests itself; yet the rate could be higher. The gradual integration of the economies of France, West Germany, Italy, and the Benelux countries is expected to spur growth as each market merges into the Common Market. New processes, new techniques, the rapid growth of consumer markets, probable further steps toward intra-European integration or at least collaboration, and the expansion of foreign trade, all contribute to the expectation of continued rapid growth. Unlike the United States and the U.S.S.R., Western Europe is undergoing some basic changes in its traditional pattern—in outlook, in scope of markets, and in ways of doing business. This “stirring up” process favors rapid growth.

It should be noted that Western Europe, thanks to the successful aid program, seems to have achieved a position between that of the United States and the U.S.S.R. The percentage of income saved and invested is much higher than in the United States, with a consequent high growth rate, but the primary philosophy is still to produce for the consumer and not, as in the U.S.S.R., for national political purposes. Thus we may consider that the Western European countries have achieved a reasonably well-balanced “growth with consumption” as their way of economic life. (See charts 2 and 3.)

CHART 2
WESTERN EUROPE'S PATH TO ECONOMIC DEVELOPMENT (1938-1950-1957)
GROWTH WITH CONSUMPTION

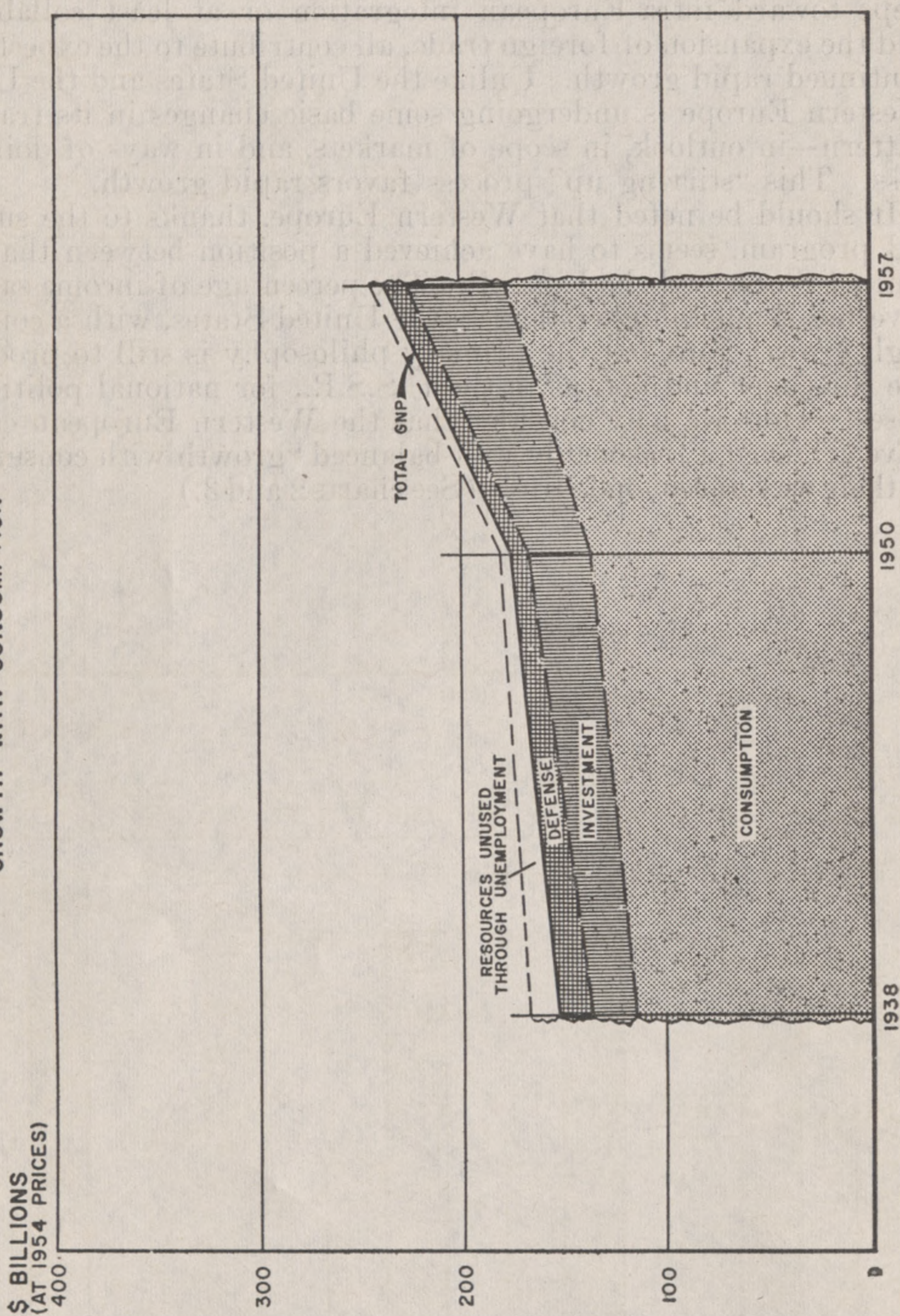
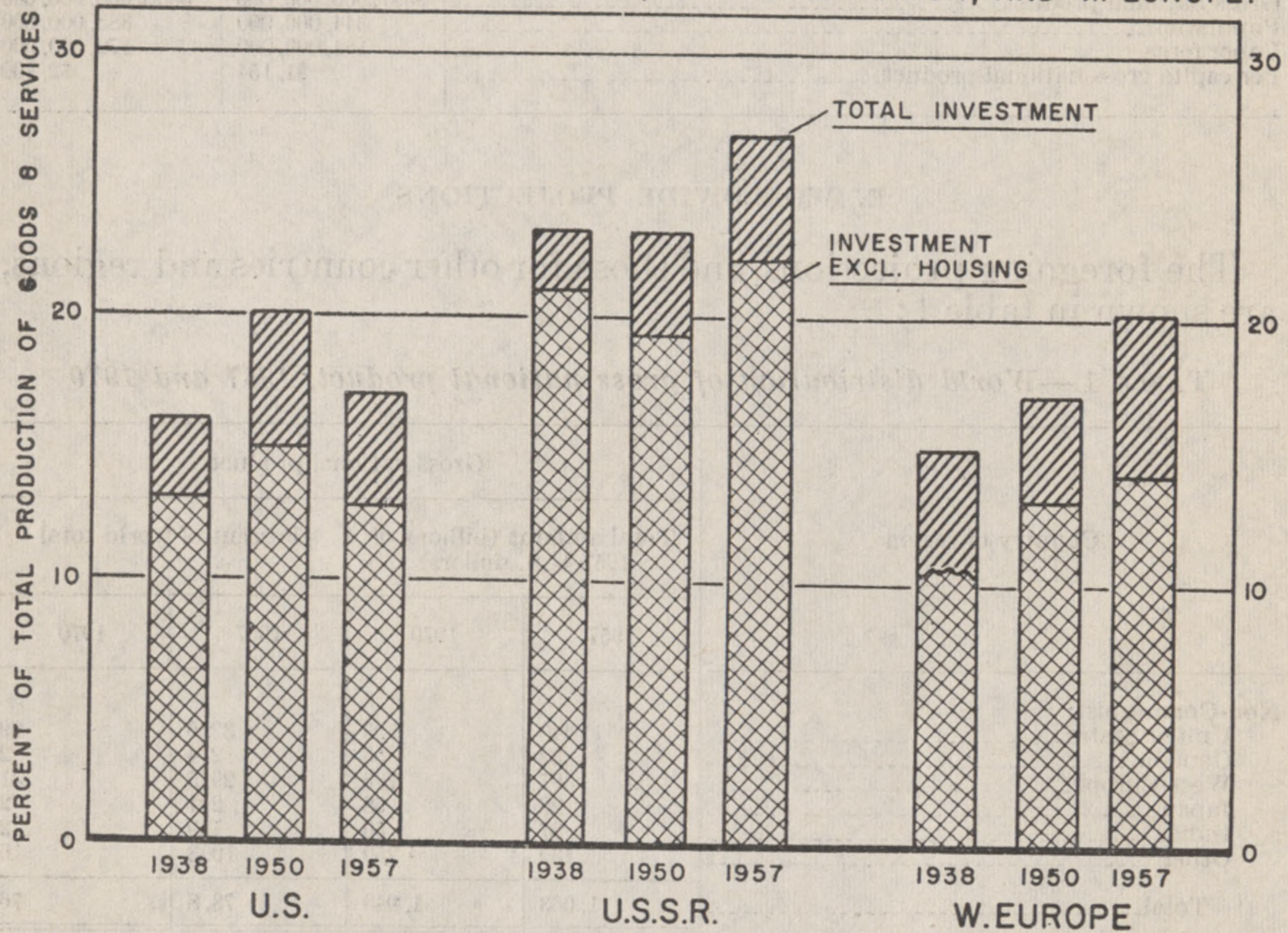


CHART 3

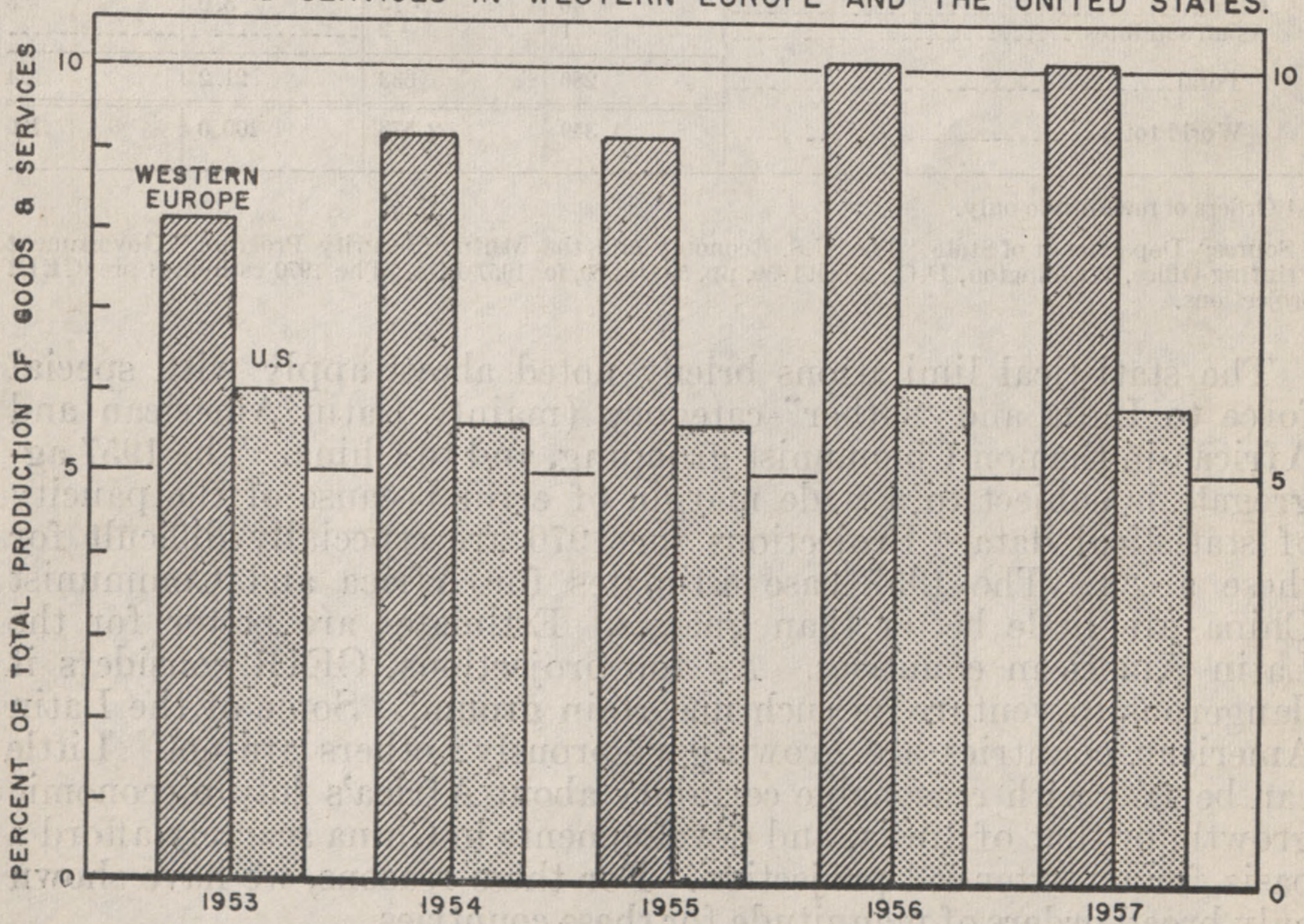
INVESTMENT TO ACHIEVE FURTHER GROWTH

INTERNATIONAL COMPARISONS

INVESTMENT AS A PERCENTAGE OF TOTAL OUTPUT OF GOODS AND SERVICES IN THE UNITED STATES, THE SOVIET UNION, AND W. EUROPE.



INVESTMENT IN EQUIPMENT AS A PERCENTAGE OF TOTAL OUTPUT OF GOODS AND SERVICES IN WESTERN EUROPE AND THE UNITED STATES.



CEIR summary estimates for Western Europe in 1970 are shown below :

Western Europe	1957	1970
Gross national product.....	\$397, 000, 000, 000	\$800, 000, 000, 000
Population.....	344, 000, 000	383, 000, 000
Labor force.....	154, 000, 000	172, 000, 000
Per capita gross national product.....	\$1, 154	\$2, 100

E. WORLDWIDE PROJECTIONS

The foregoing projections, and those for other countries and regions, are shown in table 1 :

TABLE 1.—*World distribution of gross national product, 1957 and 1970*

Country or region	Gross national product			
	Total amount (billions of 1957 U.S. dollars)		Percent of world total	
	1957	1970	1957	1970
Non-Communist:				
United States.....	440	733	32.6	29
Canada.....	32	53	2.4	2
West Europe.....	397	796	29.5	31
Japan.....	28	58	2.1	2
India.....	27	¹ 50	1.9	2
Other.....	139	¹ 250	10.3	10
Total.....	1, 063	1, 940	78.8	76
Communist:				
U.S.S.R.....	175	397	13.0	15
European satellites.....	70	159	5.2	6
China.....	40	¹ 75	3.0	3
Asian satellites.....	1	¹ 2		
Total.....	286	633	21.2	24
World total.....	1, 349	2, 573	100.0	100

¹ Orders of magnitude only.

Source: Department of State "The U.S. Economy and the Mutual Security Program," Government Printing Office, Washington, D.C., April 1959, pp. 59 and 60, for 1957 data. The 1970 estimates are CEIR projections.

The statistical limitations briefly noted above apply with special force to India and "Other" category (mainly Latin American and Africa) in the non-Communist grouping, and to China. The 1957 aggregate is subject to a wide margin of error because of the paucity of statistical data. Projections for 1970 are especially difficult for these areas. The 1957 base estimates for Africa and Communist China are little better than guesses. Estimates are better for the Latin American countries. As for projections, CEIR considers it dangerous to venture on such uncertain ground. Some of the Latin American countries are growing vigorously; others are not. Little can be said with reasonable certainty about Africa's future economic growth, or that of India, and developments in China scarcely afford a basis for an extended projection. For these reasons, we have shown only broad orders of magnitude for these countries.

India and China.—A major issue is shaping up in Asia, the outcome of which will have profound effect on American foreign policy. Both India and Communist China are undertaking major efforts to industrialize and to attain rapid economic growth. India's development program follows the democratic pattern—growth with consumption; China's program is in the pattern of totalitarian communism—heavy growth with little consumption. Their long-run relative achievements may shape the course for other, less advanced countries, in Asia and elsewhere.

A recent study examines the economic performance of these two countries.⁴ On most counts, China has had a more impressive growth record than has India, since the early 1950's. India with its democratic approach and heavy reliance on private industry, a market economy, and the conventional incentives has made progress both in growth and in consumer standards. But the facts show more rapid expansion in Communist China under authoritarian control. Some of these facts are summarized here.

From 1950 through 1958 Indian gross national product increased at an annual rate of nearly 3.5 percent. The Chinese expansion rate was about three times greater. Among other things, the Chinese performance can be laid to (1) the low level from which China started after years of war, (2) reactivating and using more fully productive capacity idled during the civil war, (3) saving and investing at rates in excess of India, and (4) directing investment to sectors having a lower capital-output ratio than India.

In 1950, the gross investment ratios in both countries were about the same—about 10 percent of gross national product. By 1958 India had raised its ratio to 13 percent and China its ratio to 22 percent. The real level of investment in India just about doubled over this period; in China it increased about fivefold. Over these years, China invested about 40 percent of its additions to gross national product; India invested about 20 percent of its gross national product increments. Both obtained external capital to supplement internal capital accumulation. India financed 60 percent of its import surplus by drawing on its foreign exchange reserves. China's import surplus was financed mainly by loans from other Communist countries, principally the U.S.S.R. The more intense and typically Soviet Chinese investment effort shows up another way: Over these years India consumed about 85 percent of its gross national product while China consumed less than 75 percent.

In total agricultural output, China showed a 25 to 30 percent growth, India 15 to 20 percent. The contrast is sharper in industry. With 1952 as the base year, the Indian industrial production index was 137 in 1958 and the Communist Chinese 288. The latter index exaggerates the growth in capacity; some of the expansion involved using previously idle resources. In 1950, China's production of steel, cement, electric power, and textiles was below that of India; by 1958 China had passed Indian output in these items. However, consumer goods production in India expanded more than in China in these years, reflecting a basic difference in the democratic and Communist approaches to developmental policy.

⁴ Malenbaum, Wilfred, "India and China: Contrasts in Development Performance," the American Economic Review, vol. XLIX, No. 3, June 1959.

Not only has Communist China achieved higher investment ratios and a more concentrated investment effort, but it also gets more output per unit of investment than does India. Malenbaum's estimates show a capital-output ratio of 2.2 to 1 for China and 4 to 1 for India. India invests more of its capital in services and social overhead, China more in industry with its greater, short-run "efficiency." Forced labor in China may also account for some of the difference by keeping down costs of capital installation. Moreover, China can direct its investments into areas of its centralized choosing; some 97 percent of industrial investment is undertaken by government. In India, two-thirds of investment in industry is private, only one-third is government. Thus consumer choices play a large role in Indian investment but little in China.

Again, the consumer interest and the role of markets in India are evidenced by the fact that the private sector produces 90 percent of the current flow of goods and services. And the bulk of savings come from private sources, largely for private investment.

As Malenbaum says:

The Government of India, currently responsible for less than 40 percent of total investment in India is * * * much more heavily dependent on outside, nongovernmental sources of investment than is the Government of China, which is responsible for more than 80 percent of the total investment in that country. The domestic savings ratios in India do not seem to have expanded since 1955, and government has had considerable difficulty in attracting them to public investment * * * India's public development program over the next few years will certainly be more heavily dependent on foreign resources than in the past. * * *

Essentially, the contrast between Indian and Communist Chinese economic development thus far during the 1950's stems from the relatively large and concentrated investment effort of the Chinese, achieved by a system of authoritarian controls. India could perhaps do more within its present democratic framework, but it is obvious that much more can only be achieved if she receives substantial capital inflows from abroad.

One important factor should be brought out. Japan, China, India, Africa, Latin America, and the other low-income areas—which together will contain over 70 percent of the world's population in 1970—now have only \$235 billion of income, combined, a little less than half that of the United States, which will have only 6 percent of the world's population in 1970. Clearly, the Soviet cry to the peoples of those countries that "you have nothing to lose but your chains; you have a world to win" will become even more potent in its disruptive effect unless something is done to improve markedly their lot. Yet this is an extremely formidable task. In such countries consumption—just to stay alive—takes almost all income and there is only a pitifully small percent of the gross national product available for investment and growth. On the whole, their own savings and investment will support no more than almost 2 percent per annum growth, just about the amount needed to provide for the new mouths to be fed. It is vital that we realize that such countries in the free world, with an income of about \$195 billion in 1957, require an external capital inflow of the order of \$10 to \$15 billion per annum to obtain a net improvement of about 5 percent per annum in total output and stand-

ard of living. In other words, any program of economic development for the underdeveloped countries requires capital on a vast scale if it is to have any significant effect in countering the corrosive influence of Soviet efforts in these areas of the world. This is a basic fact of life we must face in the decade ahead.

In terms of relative position in world productive activity, the percentage figures in table I (See p. 34) bring out the main points. In 1957, nearly one-third of world production was found in the United States and nearly 30 percent in Western Europe. The North Atlantic region of the free world (the United States, Canada, and Western Europe) produced some 65 percent of the world's output. The Communist bloc accounted for a little over 20 percent.

Looking ahead to 1970, the estimated projections suggest: (a) the U.S. share in world output may slip from 32.6 percent to an estimated 29 percent; (b) the United States remains the largest single producer by a substantial margin; (c) Western Europe increases its share of world output, from 29.5 to 31 percent; (d) the United States by itself and Western Europe as a region each produces more than the combined Communist bloc; (e) the Soviet Union and its bloc gain in relation to the free world, rising from 21 to almost 25 percent of total output by 1970.

The free world, and the United States in particular, does not appear to face the prospect of a radically changed relative position in world productive activity. However, we must not let this fact lull us into complacency, since the position of the Soviet bloc is considerably enhanced. Its growing economic strength seems a certainty. For U.S. foreign policy and the political strategy of the free world, this growing economic strength in support of Communist designs is dangerous. Its military importance is obvious. Its economic significance seems clear; the Communist bloc will grow as a foreign trade factor and as a potential source of capital for the underdeveloped countries. Conceivably, its sphere of influence may be substantially extended through economic penetration in support of political subversion. At the minimum, its economic growth will tend to extend its political influence and support Communist efforts to reduce Western influence. The Soviet leaders look to economic growth as an important means to victory in their "peaceful competition" with the non-Communist world.

Comparisons and projections of population growth and output per capita throw additional light on relative economic positions. Population data are given in table 2:

TABLE 2.—*Distribution of world population, 1957 and 1970*

Country or region	Number (millions)		Percent of total	
	1957 ¹	1970 ²	1957	1970
Non-Communist:				
United States.....	171	204.0	6.1	6
Canada.....	17	20.8	.6	1
West Europe.....	344	382.8	12.4	11
Japan.....	91	109.0	3.3	3
India.....	392	504.0	14.1	14
Other.....	817	1,067.6	29.4	31
Total.....	1,832	2,288.2	65.9	66
Communist:				
U.S.S.R.....	204	254.0	7.3	7
European satellites.....	96	109.4	3.4	3
China.....	630	799.0	22.6	23
Asian satellites.....	23	29.4	.8	1
Total.....	953	1,191.8	34.1	34
World total.....	2,785	3,480.0	100.0	100

¹ U.S. State Department "Indicators of Economic Strength of Western Europe, Canada, United States and Soviet Bloc, 1957." Intelligence Rept. No. 779, Aug. 15, 1958.

² United Nations, "The Future Growth of World Population," 1958, app. C, table 2 and table 1a. Median assumption.

There is no significant shift in world population as between non-Communist and Communist countries over the years to 1970. While the United States and Western Europe show a relative decline, the other parts of the non-Communist world increase. The most rapid rate of growth is projected for Latin America. The importance of this shift is discussed elsewhere in this report.

Per capita gross national product estimates are as follows:

TABLE 3.—*World per capita distribution of gross national product, 1957 and 1970* ¹

[In 1957 U.S. dollars]

Country or region	1957	1970	Approximate percent increase
Non-Communist countries:			
United States.....	2,570	3,593	40
Canada.....	1,899	2,548	35
Western Europe.....	1,154	2,079	80
Japan.....	308	532	70
India.....	69	² 101	² 50
Other.....	170	² 234	² 40
Communist countries:			
U.S.S.R.....	858	1,563	80
European satellites.....	729	1,453	100
China.....	63	² 94	² 50
Asian satellites.....	45	² 68	² 50

¹ Computed from tables 1 and 2.

² The 1970 per capita projections for these countries, whose output or population estimates, or both, are subject to a wide margin of error, are considered extremely speculative.

Percentage growth in per capita output varies greatly, reflecting the projected annual rates of gross national product expansion and the additions to population. The Communist countries and Western

Europe show the largest percentage increases, although the United States maintains a substantial lead in per capita output in these projections.

Per capita differences in 1957 reflect great structural contrasts in economic activity, and major differences in economic power. The high per capita regions (North America and most of Western Europe) are the predominantly industrial economies. In these regions industry and trade account for two-thirds of the national income (output) while agriculture on the average accounts for about 10 percent or less. Nonagricultural activity provides 70 percent or more of the employment, and agriculture 30 percent or less (e.g., 11 percent in the United States).

On the other hand, agricultural employment provides 50 percent or more of employment in the Communist bloc, with two exceptions: Czechoslovakia and East Germany. The preeminence of agriculture as a means of employment and source of income also characterizes the less developed nations outside the Communist bloc.

The per capita data suggest a rough classification of countries, as follows:

1. The high income (output) countries which are predominantly industrial and trading nations, such as the United States, Canada, the United Kingdom, and most of the non-Communist European countries.

2. The intermediate income (output) countries with a sizable industrial sector but in which agriculture accounts for 40 to 60 percent of total employment; the U.S.S.R. and most of its European satellites are in this category.

3. The low income (output) countries in which agriculture predominates, providing work for 60 percent or more of the population. Most of the Asian countries, the Middle East, Africa, and much of Latin America fit into this category. In this category there are great differences in the rate of industrialization and growth among countries.

The per capita projections of CEIR indicate a narrowing of the ratio of per capita incomes (output), i.e., of the relative difference, but a widening of the absolute difference, between the North Atlantic countries and the Soviet Union.

Perhaps the greatest cause for concern is the fact that the underdeveloped countries will show no improvement in per capita income relatively to the developed countries. Disparities, in fact, tend to grow rather than diminish. This fact is one that has great psychological advantages for the Soviet in its economic and political offensive. Without prospects of relative progress compared with the rest of the world, the underdeveloped countries will, perhaps, feel more tempted to accept the Soviet argument that it is only through violent change—through Communist planning—that they can hope to improve their lot. The free world must offer a similar bright hope for progress to counter this possibility. Even though Communist planning cannot in fact deliver on its promises to such underdeveloped countries—since they have no margin on which to reduce their consumption to increase investment—the danger is that the experiment will be tried, with dire consequences in the form of severe economic hardships leading to uncontrollable political unrest and eventual assumption of power by force by the Communist Party or its puppets.

These per capita projections and the contrasts shown in table 3

follow, of course, from CEIR's gross national product projections and the United Nations' population forecasts. The latter are much less susceptible to error than output projections. How reasonable are CEIR's gross national product projections and therefore per capita estimates for 1970?

A check of limited validity is suggested by comparing per capita energy consumption (output) with per capita gross national product for the major countries and regions. Per capita energy consumption is measured as the metric ton coal equivalent. Per capita gross national product and per capita energy consumption in general vary together. This is indicated in the following data:

	Per capita gross na- tional prod- uct, 1957	Per capita energy con- sumption, 1957 (metric tons hard coal equivalent)
United States.....	\$2, 570	8.3
Canada.....	1, 899	7.7
Western Europe.....	1, 154	2.5
U.S.S.R.....	858	2.4
European satellites.....	729	2.5
China.....	63	.17
Asian satellites.....	45	.13

Per capita energy consumption estimates for 1970 are available for the United States and the U.S.S.R.; they are 12.2 and 5.9 tons, respectively. When the 1970 energy estimates are related to the 1957 data on per capita gross national product and per capita energy consumption, the 1970 output projections in this report appear reasonable.⁵

F. SOME GENERAL COMMENTS ON PROJECTED GROWTH RATES

1. Given the ideological aspirations of the Communist bloc, the projected rate of economic growth points clearly to increasingly difficult cold-war problems for the United States. The varied types of difficulties that can and probably will arise and grow are suggested later in this report. But first some comments are in order on the causes of rapid Soviet growth.

Let it be emphasized that there is no mystery about Soviet growth performance.⁶ The Soviet economy as such holds no special or unique features which explain it. Apart from their political control apparatus, Soviet growth is due to the same basic economic causes and conditions which operate in any economy, whether it be capitalist, Communist, or some other type. In general terms, growth depends on expansion of resources and the productivity of resources. The key item in resource growth and in productivity is capital accumulation.

⁵ See Mason, Edward, "Energy Requirements and Economic Growth," National Planning Association, 1955.

⁶ There is, however, disagreement over this performance. Prof. G. Warren Nutter, in "Industrial Growth in the Soviet Union," the American Economic Review, May 1958, No. 2, vol. XLVIII, states the view that Soviet industrial growth "has proceeded at about the same average pace as American industrial growth over the same period (i.e., 1913-55)." Most experts in this field disagree. See the detailed statistical critique by Rush V. Greenslade and Phyllis A. Wallace, "Industrial Materials as a Measure of Industrial Production, Soviet Union Versus United States," to appear in the September 1959, the American Economic Review.

The Soviet system, through its dictatorial control of labor, is, however, able to exploit capital more intensively through multishift operation than is the West.

Expenditure on capital in its principal forms—such as machinery, plant equipment, and productive installations of all types—is a component of gross national product, along with consumer goods and services, military end items, and, depending on classification, other goods and services for governmental purposes. All these end uses compete for the resources available to produce them. These resources are scarce; at any given time there is obviously some upper limit to the amount of gross national product that can be produced. More capital accumulation under certain circumstances leaves less for immediate consumption, or for military use, and vice versa.

Rapid Russian growth, past and projected, rests on a basic political fact: the Soviet Government's ability to hold down consumption through the Communist control apparatus and thus to foster sizable compound accumulation of capital and military strength. So long as the bulk of the year-to-year increase in gross national product is directed to further expansion of investment rather than consumption, a remarkable compound growth rate can be sustained. As noted above, the control apparatus limits consumption to about 55 percent of Soviet gross national product. The remaining 45 percent is apportioned among investment (capital accumulation), the military, and other Government purposes. Capital accumulation is variously estimated; gross investment of 27 percent of gross national product is probably the best estimate of the order of magnitude. In any event, theirs is a rate of capital formation well in excess of the 17 percent recently prevailing in the United States.

Reflecting the practice of plowing back additional income into further investment for still greater growth is the fact that capital in the Soviet Union is more heavily concentrated in the capital-producing industries than in the United States or elsewhere. Capital to produce more capital; this is the emphasis, and it produces rapid growth, although by U.S. standards it is a distorted growth. Consumer goods industries are neglected; they are obliged to make shift with obsolete capital that long since would have been scrapped in the industrially more advanced countries. Moreover, by merely copying the designs of consumer goods in the consumer-oriented countries, engineers and scientists can be conserved for the advance of production and military technology. The emphasis on capital-producing industries also bypasses the huge investments made here in social overhead, such as housing and municipal facilities. Even by Soviet admission, housing is short and of poor quality. Outside the major cities, street lighting and sewer systems are at best of low standard and often nonexistent.

Their concentration of capital investment in industry produces some impressive results and striking contrasts. First-rate technological performances in aircraft, the missile industry, ordnance in general, some parts of the machine-tool industry, and others stand in contrast to remnants of the plant and equipment taken over from the Czarist regime. There are wood-burning locomotives and peat-fueled thermoelectric plants, both of which, however, can still deliver goods and energy to an ultramodern military electronics plant.

Thus the Soviets achieve their high rate of growth by slicing off a large fraction of gross national product for capital building; they parlay capital on capital. West Germany has achieved a comparable growth rate with more conventional controls, though, until recently, the burden of armaments did not limit consumption and capital accumulation. Again, there is no mystery to rapid growth; principally, it takes much capital, directed to purposes designed for growth.

2. A second general comment needs emphasis: There is nothing automatic in the growth process. Countries can and have stood still, and some have retrogressed. The projections in this report rest on many assumptions. Among them is the assumption of a sustained capital growth, here and throughout the world.

In the United States and in the Western industrial countries, generally, capital is saved and invested voluntarily. The growing annual increments of capital presupposed in the projections require for their fulfillment: (a) the ability and willingness of people and business firms to save a somewhat larger percentage of income than heretofore; (b) the existence of adequate incentives and opportunities to save and invest; (c) the flow of technical innovations to cut costs and yield new products; (d) the expansion of international markets; (e) wage, cost, and price relationships which are consistent with expanded output and world trade; (f) a confident, dynamic growth attitude of business leaders; (g) tax, expenditure, trade, and regulatory policies of Government which do not further inhibit capital growth, competition, and trade. These general assumptions—and many others as well—are mainly a projection of the recent past into the future. But some shifts and changes are needed; these will be touched upon from time to time.

A mere listing of the general assumptions supports the main point: growth is not automatic; it is not to be taken for granted. Complacency in business, short-sighted demands of union leaders, extravagance of Government, errors of policy and administration, and apathy of the public—these would bear heavily on the basic forces and prospects of growth, here and abroad.

In short, economic growth is not a windfall; it must be earned.

While the extent of the diminution of the U.S. share of world income in the next decade is nothing dramatic, it does reverse the rising trend which has characterized all our history. Moreover, if continued for 2 or 3 decades the diminution will become quite substantial, and the balance of world power will shift still more to the Soviet bloc which, unlike the community of free and independent nations, can act as a monolithic political unit. The basis of our lag is, of course, our low percentage of saving and investment. It is something of an anomaly that the United States, a country with the highest level of income in the world, is the country with one of the lowest saving and investment percentages of all the developed wealthier countries.

This raises the important question of whether our rate of growth is not becoming a national problem, even a vital defense problem. We can no longer look with equanimity on our relatively slow growth. Naturally, it is not in our nature to allow the Government to become an important agent in domestic investment activities. But we have come to accept the fact that individuals and free enterprise cannot

spontaneously provide for defense and foreign economic policy and that this must be the concern of Government. We should now realize that the rate of growth of the economy should also be the concern of the Government. Indeed, the success or failure of both the Congress and the administration in the economic area should be judged by the extent to which our economic growth is promoted. Closely related to the question of rapid, sustained economic growth is the problem of recurring recessions. While these adjustments are unavoidable in a complex, free economy, it is incumbent on Government to minimize their intensity and duration and on no account to let any one of them drift into becoming a serious depression. In the light of our world problems today, the latter would represent not merely an internal economic disaster, but an external political defeat of the greatest magnitude.

There are many legislative and administrative measures which can be taken to foster a higher rate of growth of the U.S. economy. The prime targets should be to increase the percentage of income saved, and to increase the rate of investment, both of these in the private and not in the public sector. In the case of savings, the major problem is to induce the large and middle income groups, who receive the great bulk of the total personal incomes, to save and invest. With present tax rates, saving is not encouraged. Much could be done to reward thrift by making appropriate tax concessions to these income groups on the additional income obtained from investment. The efficiency of this is demonstrated by our residential construction activity which is so high partly because of the stimulus of tax relief on mortgage interest. However, this "investment" is really consumption.

On the investment side, industry can be induced to invest by suitable tax concessions also. Moreover, it is up to the Government to use all its fiscal and monetary weapons, as well as its own programs of defense, foreign aid, conservation, et cetera, to create favorable conditions for the economy to generate a demand ample to absorb the output of all the capacity which can be financed by the savings forthcoming.

Perhaps our greatest need is to raise our sights as a nation in our future income objectives, in our defense program, in our assistance to the underdeveloped areas—to stop looking over our shoulder at the "boom and bust" that happened over a generation ago, and start to race. Above all, we should cease concentrating on parts of our whole complex financial system and look at the whole—the budget, monetary management, the banking system, the external financial situation, the private sector—from the point of view of healthy dynamic growth over the next few decades. Fortunately, we have learned a great deal about how the American economy works in the last 30 years, and much can now be accomplished by appropriate public policies which harness beneficially the tremendous driving force—private profit—which is the mainspring and the greatest asset of our free enterprise system.

One caution here may be in order. It is natural that the rise in per capita income should lead to the demand for greater leisure and for a shorter working week. Yet, in the present world context, we cannot, as a nation, afford this luxury. An increase in saving and investment would require continuation of our 40-hour week so that we may continue to enjoy our levels of consumption while yet achieving higher rates of growth. If we can afford a 35-hour week we can, as

a nation, afford the savings for a higher rate of growth. For the worker these savings mean a greater income to enjoy his leisure at retirement, instead of greater leisure without increased income now. Our unions would perform a very useful public service if they directed their bargaining efforts to increases in retirement and profit-sharing plans, both of which lead to both saving and investment.

II. PRODUCTIVITY AND GROSS NATIONAL PRODUCT GROWTH RATES

The growth of output in the past and that projected for the future stem from two general causes: (a) an increase in resources in a country, and (b) improvements in the productivity of these resources. Productivity improvements largely account for the rise in output per head. These improvements result from a number of complex causes whose effects are difficult to isolate and virtually impossible to measure:

1. *Increase in capital equipment per worker.*—In the United States net capital growth has averaged 2.5 percent per annum over the last 50 years. Allowing for the growth of labor, capital additions per man-hour of labor are estimated at an annual rate of 1.8 percent. This has increased horsepower per wage earner in manufacturing from 1.25 in 1879 to 10 horsepower at present.⁷ Automation, involving the progressive reduction of human intervention in the production process, is an essential feature of current capital investment and productivity improvement.

2. *Change in size of productive plant.*—Plants may be too small for optimum productivity; increases in scale often augment productivity. Some may be too large; in this case, reduction in size would increase productivity.

3. *Improvements in the quality of labor, management, and capital.*—Labor quality is improved by education, training, better health standards and conditions of work. Scientific and technical advances increase the quality and efficiency of capital over time. Improvements in the efficiency of management add to productivity, and the more modern scientific management aids are providing increasing possibilities for progress in this area.

4. *Improved methods of combining resources.*—Improvements in plant layout, materials flow, inventory control, communications, and operations are involved here. The receptivity of business management—public or private—to new ideas, methods, and combinations of resources is the decisive factor.

5. *Sector shifts.*—Gross national product per man-year grows as resources shift from sectors of lower value product per man-year to higher product sectors—for example, from agriculture to nonagricultural employment, or from household services to agriculture or industry. Sector shifting is estimated to account for between one-fourth and one-eighth the average annual increase in productivity in the United States.⁸

Productivity improvements over a long period in the United States have averaged about 1.7 percent per annum. This is roughly one-

⁷ Taggart, Joseph H., and Clark, Clifford D., "Wage Theory, Wage Rates, and Productivity," a business research study of the Graduate School of Business Administration, New York University, 1958.

⁸ Taggart and Clark, *op. cit.*

half the average annual increase in gross national product. The long-term average conceals pronounced short-term variations, as the many estimates of this complex subject show. Since World War II (1948-57) there has been some acceleration in productivity improvement, averaging somewhat more than 2 percent per year.

The evidence on Soviet productivity improvement is incomplete and subject to considerable differences in interpretation. Statistics on output are incomplete and often conflicting. Even more uncertainty attaches to labor and capital inputs. Thus the estimates of productivity must be considered with caution.

By their own statements, the Soviets admit to an unsatisfactory productivity performance in agriculture. For example, 1½ to 2 million workers are engaged in gathering wood and other low-grade fuel in the countryside. Moreover, reorganization of the economic control apparatus in 1957 was partly explained by them as a means of improving productivity, previously inhibited by excessive bureaucratic centralization. Soviet technical literature discloses productivity problems in many industries. Over the length of the Soviet regime agriculture has lagged but industry has grown enormously. To what extent has this growth been due to special productivity gains or to an increase in productive factors in this sector?

With all their limitations Soviet statistics, as adjusted by Western statisticians, throw some light on this question. One recent study compiled indexes of industrial production, employment, and capital stock in the U.S.S.R. for 1928 and 1940 and related the results to U.S. experience.⁹ By 1940 the increase in capital stock was 2.4 times the increase in labor and 1.7 times the increase in output. Capital increased 18 percent and labor nearly 10 percent per annum. These are rapid growth rates for the 13-year period. However, a caution must be entered here. The production data apply to large-scale industry and some of the growth represented a transfer of resources from small- to large-scale enterprises. In the earlier years of this period, therefore, capital stock estimates are probably understated and the capital stock growth overstated.

Looking at early U.S. industrial experience, in the 24 years from 1899 to 1922 capital also increased 2.4 times the industrial labor force and 1.7 times industrial output. In the years 1928-40 Soviet output increased 1.8 times as much as U.S. output, although part of this greater growth rate may be due to the exaggeration of Soviet production indexes as noted above.

The output/input relationships for the two countries in these periods are practically the same. While the estimates must be viewed with caution, they indicate about the same productivity experience. The expansion of Soviet industry seems best explained by the massive shift of labor and a rapid accumulation of capital, not superior productivity techniques. Had the United States pumped labor and capital into industry at the same speed, comparable yearly rates of industrial growth presumably would have occurred here.

Berliner also shows data on postwar changes in Soviet output, employment, and capital formation between 1948 and 1956. Both cap-

⁹ Berliner, Joseph, "Capital Formation and Productivity in the U.S.S.R.," Special Publications Series No. 14, 1957, National Academy of Economics and Political Science, Washington.

ital and labor growth rates slowed during the postwar period to 15 percent (still a high figure) and 3.6 percent, respectively. Capital stock increased 2.3 times as much as labor, just short of the prewar multiple. The estimates suggest that the productivity of both labor and capital have increased in the postwar years. But the estimates again need qualification. Production in 1948 was still below capacity because of material shortages; the climb partly reflects a return to capacity output. Moreover, the investment data seem to exclude lend-lease equipment and postwar booty. Both qualifications, coupled with excessively slow amortization of obsolete Soviet equipment, might alter the tentative conclusion on productivity improvements. Although the Soviet situation is not clear, higher productivity rates in the postwar years, over the prewar decade, are evident in the United States, Western Europe, Japan, and probably in other nations as well.

Given the nature of the Soviet statistics, the highly uneven development among Soviet economic sectors and within the industrial sector itself, and the major contrasts between the organization of Soviet industry and that of the United States, no firm conclusions can be drawn on the respective productivity changes. For the period since 1928 Soviet industrial productivity in terms of man-hours has about doubled; this is an average increase of 2.5 percent per annum.¹⁰ On the same basis and for the same years output per man-hour in the United States increased about 2.5 percent per annum.¹¹

While the estimates of Berliner, Shimkin, and Leedy, and a number of other specialists, suggest no important difference in general productivity growth rates over long periods, there is no unanimity of views. There are estimates which show either better or worse performance on the part of the Soviet Union compared with the United States. In part, this depends on the time period selected. Productivity rates in the U.S.S.R. and in the free world show sizable short-run variations from the long-run average. The man-hour productivity increase from 1951 to 1956 in the U.S.S.R. averages 5 percent per year, comparable to the Western European rate.¹² For short periods the United States has performed as well or better; and all, obviously, have fallen below the long-run average for periods of time.

Productivity needs examination in terms of present comparisons of output per man, for there are some significant contrasts. In 1956, Soviet man-hour productivity in industry is estimated by Shimkin and Leedy to have been about 28 percent of U.S. industrial man-hour productivity.

By branch, Soviet industrial productivity ranges from about 50 percent of the American level in electronics and strip coal-mining to about 10 percent in logging and quarrying. The growth of [Soviet] labor productivity has been comparatively slow.¹³

The clue to Soviet industrialization—which has been impressive—is not to be found in a productivity magic peculiar to the system.¹⁴

¹⁰ Shimkin, D. B., and Leedy, F. A., "Soviet Industrial Growth," *Automotive Industries*, January 1958.

¹¹ See report prepared by the staff of the Joint Economic Committee, June 21, 1957.

¹² The projections of Soviet gross national product in this report assume a continuation of approximately this postwar rate of increase in labor productivity. The present Soviet plan calls for substantial technological changes, including automated equipment, in the years ahead. This gives warrant to the assumption of higher rates of increase in Soviet productivity compared with long past trends.

¹³ Shimkin and Leedy, *op. cit.*

¹⁴ That problems of productivity, obsolescence, and organization disturb Soviet leaders is evident from Moscow reports summarized in the *New York Times*, July 1, 1959.

Rather it is to be found in their massive accumulation of capital in, and shift of labor to, the industrial sector—they have employed essentially a bulldozer approach to the problem of economic growth. Industrial employment has risen from 5.6 million in 1928 to nearly 23 million in 1956. Capital stock has increased eightfold to tenfold over the same period.

The particular directions, or industries, into which these resources have gone is the important point, more important than general rates of gross national product growth or productivity changes. Thirty years ago consumption accounted for about 60 percent of Soviet industrial output; it is now about 27 percent. Capital investment and armaments absorb the remaining 73 percent. Since 1928 half of the country's total investment has gone into industry, and of this, 85 percent goes into producers' rather than consumers' goods industries. In 1956 the Soviet production of industrial equipment equaled about 65 percent of U.S. industrial equipment output. However, their industrial equipment on hand is roughly equal to 40 percent of U.S. installed industrial equipment; 30 years ago it was only 8 percent.¹⁵ Again, this shows the concentrated effort of Soviet investment.

Their concentration has produced an immense armament industry of diversified character, and a capital goods industry equal, in some lines such as machine tool production, to that of the United States. In a number of capital goods lines the Soviets are now in a position to export in quantity. At the same time, the concentrated industrial effort has increased Soviet needs for imports. The emphasis given to their development program therefore suggests the prospects of growing and sizable involvement in world trade. Some implications of this involvement on the United States and the free world will be discussed later.

III. GENERAL CONCLUSIONS AND IMPLICATIONS

1. The long-term growth trends of the United States, Western Europe, the Soviet Union, and in many other countries, have accelerated during the post-World War II years. Economic expansion has been particularly impressive in the Soviet Union, and Western Europe and Japan show somewhat similar performances.

There are powerful forces abroad in the world—economic, demographic, social, and political—which favor continued, rapid economic growth. CEIR projections for the 1960's assume that these forces will prevail, in the absence of destructive war or disruptive political developments in the major centers. Among these forces are (a) a recordbreaking increase in population; (b) a growth and dynamic change in consumer demand throughout the free world; (c) the "stirring up" of peoples in the long-stagnant economies of the underdeveloped parts of the world; (d) the resurgence of enterprise in the old industrial economies of the West; (e) the high standing given to economic growth on the agenda of economic policy; (f) the growing economic rivalry among the blocs of nations; and (g) far-reaching technological and organizational changes which will create economic opportunities and foster incentives. These forces call for an accumulation of capital and levels of employment unparalleled in the past.

¹⁵ Shimkin and Leedy, *op. cit.*

The CEIR projections show a greater growth rate for the U.S.S.R. and Western Europe than for the United States, 1957-70. Both these production centers gain somewhat in total output relative to the United States; gross national product in Western Europe will be somewhat above that of the United States and double the Soviet total.

2. Although its share in world output will not change much at all, the United States will find itself in a considerably altered economic environment as the 1960's proceed. A decade ago it was the production center of the world, the only significant source of capital. Its goods were sought throughout the free world, practically without competitive pressure. Generosity combined with national interest prompted vast relief, rehabilitation, and development programs abroad. These policies worked well where the emphasis was placed—in Western Europe. Meanwhile the Soviet Union made a rapid comeback and like Western Europe broke into new, high ground in the 1950's. As this decade comes to an end, the industrial sector of the world is on its feet and on its own; the remainder will still need great help. As the 1960's take their turn, the United States will find itself no longer alone, but one producing power among several. Unlike the last decade, the next will be one of growing competitive pressures, from friends and foes alike.

3. Expanded industrialization will give the U.S.S.R. an ever-increasing economic capability. This can manifest itself in a number of ways:

(a) Soviet trade with the free world is likely to expand greatly. Since 1953 their exports rose from \$300 million to about \$1 billion in 1958. Imports from the free world rose by the same magnitude. By 1970 an export volume of over \$5 billion annually is not beyond reason, and imports may reach the same volume. Satellite trade with the free world could equal these amounts or exceed them. However, there will be restraints on growth in trade. The Soviet range of exportable goods is conditioned by the demands of the Soviet drive for economic growth. While the satellites and China are heavily dependent on Soviet output, and take a large percentage of Soviet exports, the evidence indicates that many of these requirements have a lower priority than the claims of the program of economic penetration of the free world. For the present the ruble is inconvertible. Long-established commercial and banking connections are limited, but here the European satellites may play an important role. Substantial trade expansion seems likely on economic grounds; this necessity will be turned to political advantage by the Soviets to the greatest extent possible.

(b) The Soviets have emphasized trade with underdeveloped countries; this has grown at a rapid rate since 1953 through trade agreements and commercial credits to the accompaniment of attacks on Western trade and political influence. In general the underdeveloped countries are the vulnerable part of the free world. The Soviets and satellites will probably concentrate heavily on these vulnerable spots for political advantage and influence.

(c) The U.S.S.R. has emerged as a capital goods exporter and a source of technical assistance.¹⁶ On April 8, 1959, the Soviet delegate

¹⁶ "Foreign Assistance Activities of the Communist Bloc and Their Implications for the United States," CEIR report to the Special Senate Committee To Study the Foreign-Aid Program, 1957.

to the United Nations Economic and Social Council, meeting in Mexico City, again made the familiar offer of loans and technical assistance, coupled with an attack on the United States and the other Western Powers. This is the Soviet pattern and it can be expected to grow and spread. The mounting capital requirements and need for technical assistance in the less developed countries might increase their receptivity to bloc offers of aid and trade.

(d) The Soviets will have an increased capability of exploiting special economic situations and difficulties, as they have done in the past in Iceland, Egypt, and elsewhere.

(e) In the last year or so the Soviets have been accused of dumping some commodities to depress prices and hurt other traders. The evidence is conflicting and there are both limits and disadvantages to this strategy. But sales of Soviet tin coincided with the Malayan Government's pressure on local Communists. This could have been coincidental, but the possibility of employing this type of pressure, and causing international mischief otherwise, grows with Soviet economic strength.

(f) In general, the growth in trade and economic aid may lead to greater penetrations and influence in some or many of their trading partners. Overt political exploitation of a trading position can backfire, of course; it has already in some places. But a subtle resulting growth in political influence is a possibility which must be watched. Influence and prestige can be enhanced in many ways, including military strength, technological accomplishment, and economic performance. These are all linked and can be expected to further the general influence of the Soviets in world affairs. This influence will be used against the free world.

4. West European economic progress as projected through the 1960's will raise other issues for the United States and, at the same time, lighten some of the international responsibilities of this country.

Some of the issues can be summarized as follows:

(a) Industrial growth will increase competitive pressure from European suppliers on American business. This is already evident in third markets where European goods have displaced American goods in some instances. As these markets grow, for example in Latin America, we can expect increasing competition from British, West German, French, and other suppliers. In fact, the European satellites of the U.S.S.R. are getting some of this business and will probably get more.

(b) European firms are now more able to supply their own markets, displacing some American imports.

(c) Increasingly, European competition is likely to grow in the American market. The Greer Ferry and TVA generator episodes illustrate the point. Instances are likely to multiply and, with them, pressures for restrictive, protectionist policy.

Competition, of course, is not confined to the Western European countries. Japanese exports to third countries and to the United States have increased competitive pressures. The voluntary quota arrangement on Japanese textiles is a protectionist reaction to this competition. As industrialization proceeds in India and other underdeveloped economies, similar situations are likely to develop.

In large part, the growth of European and Japanese trade involves the reestablishment of traditional trade patterns that had been dis-

rupted by World War II and its aftermath. But new competitive patterns are likely to emerge as industrialization proceeds.

Despite the growing trade importance of these countries, U.S. exports will expand as world production rises. But U.S. exporters will not enjoy the preferred position of a decade ago. They will meet vigorous competition, in terms of price, quality, delivery schedules, service, product variation, and innovations. In some competitive lines the United States is a high-cost producer, as the electric generator episodes indicate. In many other lines the United States is the real competitor, as evidenced by the restrictions imposed abroad on the import of certain U.S. goods.

On the other side of the coin there are distinct advantages to the resurgence of Europe, not the least of which is competitive stimulation. The industrial nations of Europe no longer need economic aid such as was extended them by the United States in past years. Their prosperity expands the markets for raw materials and basic products produced in many of the underdeveloped countries and in the United States. And capital exports from Europe, now growing, will ease the relative burden on the United States as a supplier of capital to the less developed countries. These benefits—the strengthening of the free world economy through growth, expanded trade, and capital flows—are in part the result of and mark the success of U.S. foreign aid. European growth and trade will loom ever-larger in the struggle between the free world and the Communist bloc.

5. While the international environment has changed in recent years and will continue to change in the decade ahead, the position and influence of the United States in this altered environment are not ordained. It could be worse or it could be better than suggested in the foregoing. For one thing, the Soviets could encounter more difficulties than here assumed; West European expansion could lose steam. Neither seems likely. For another, the position of the United States is a variable. It could worsen if growth rates slowed up. But it could improve. Circumstances, opportunities, and policy could combine to increase materially the growth rate here envisaged. The U.S. potential for growth is enormous—greater than that of the Soviet Union or West Europe. If rapid growth is urgent, and if this urgency is manifest to leaders of business, labor, Government, and to the public in general, then growth could exceed by a wide margin that projected in this report for the United States.

Such a sense of urgency is not now evident. The United States basically has no growth policy. There are elements of one, here and there. We spend heavily on highways; agricultural research is fostered; the merchant marine is supported, and so on. But public policies that inhibit growth probably have greater weight than those in support of it. The cost-increasing effects of price supports, quotas, tariffs, high corporate taxes, to mention a few, limit growth potential. Many business and labor practices restrain productivity and raise costs. Growth involves change and often dislocations which hurt particular groups. Policy and practice tend to resist adaptations to such changes, thus making for inflexibility in the system. Such public and private policies and practices are motivated by interests which are indifferent to growth requirements and to their effects on the international economic position of the United

States. Despite this indifference and the inhibitory effects of policies and practices, growth goes on. A policy of growth could greatly speed the process.

Growth policy can take two general lines: (a) The removal of inhibitions to the strong, indigenous forces of growth operating within the economy, and (b) public actions which attempt to increase and to direct investment under the aegis of Government.

The former line of action—the removal of inhibitions on savings, investment, mobility, and risk ventures—is the more certain of success and consistent with tradition. This country has risen to world industrial preeminence on its indigenous forces of growth—the industry, enterprise, and prudence of its people. As a first step, the Congress might well examine the legislative framework from the standpoint of its effects on long-term growth and therefore on foreign policy as set forth in the recommendations.

Vigorous growth is essential to U.S. national interest in an international setting characterized by rapid growth elsewhere. Rapid economic growth, besides easing the problems of change and adjustment within the economy, is a basic element in future shifts in world power. The Machiavellian use of such growth by the Soviets—with only about 13 percent of total world income—in buffeting the free world since World War II, teaches an unmistakable lesson. It will be the problem of sustained rapid growth—in the leading free world nations, and especially in the underdeveloped countries—which will hold the key to the eventual outcome of the cold war.

CHAPTER 2

INTERNATIONAL TENSIONS AND THE UNDER-DEVELOPED COUNTRIES

I. INTRODUCTION

International tensions and therefore foreign policy difficulties will be aggravated in the years ahead by the requirements and problems of the underdeveloped countries.¹⁷ Only certain aspects of this subject will be considered here—those that fit into the framework of this report. Another report sponsored by the committee covers the subject more comprehensively.

The points of importance here are confined to (a) the probable change in the capital requirements of the underdeveloped economies, (b) the availability of external government and private capital to help meet these requirements, (c) the trade prospects for the underdeveloped economies as elements in their growth outlook, and (d) the probable role of the Communist bloc in meeting their capital requirements.

By way of anticipating some of the subsequent discussion, these points can be made:

1. Capital requirements in the less developed countries, from both internal and external sources, are certain to mount rapidly if any significant "growth with consumption" is to be achieved rapidly.

2. Many of the Western European countries can now expand or resume their capital exports, both public and private, because of their strengthened economic positions.

3. The Soviet Union repeatedly announces its willingness to aid the underdeveloped countries; its present efforts are significant in some areas and it has a growing capability for doing much more.

4. Exports from the underdeveloped countries will undoubtedly increase; these are largely raw materials and basic commodities subject to the substantial price fluctuations which create exchange difficulties and hamper their orderly capital goods inflow.

5. U.S. capital exports in the form of Government aid, private direct investment and portfolio investment, have dominated capital flows since World War II. This might change in the decade ahead; our freedom of action in undertaking international commitments could easily be affected by a hasty reaction to the U.S. balance-of-payments deficit. This aspect of the foreign aid problem has scarcely entered into foreign policy considerations in the past. The balance-of-payments problem is discussed in some detail in chapter IV.

¹⁷ There are great differences among the "underdeveloped" economies; the adjective is not appropriate but has wide usage. Some are industrializing rapidly, others have as yet shown little sign of doing so. For present purposes the many differences in stage of development and future prospects will not be elaborated.

II. CAPITAL NEEDS IN UNDERDEVELOPED COUNTRIES

This report will not attempt an estimate of the capital requirements, present or future, of the vast underdeveloped areas of the world. Paul Hoffman recently estimated the external requirement of \$30 billion for the next decade.¹⁸ For a number of reasons a global estimate is difficult to establish factually.

What might be needed has no limit unless some level of the rate of growth of income and consumption is established; what can be used productively has roughly ascertainable limits when account is taken of the interest cost. Both criteria tend to get confused. External requirements are supplements to internal sources; the latter are governed by per capita income, distribution of income, willingness to save and invest, public policies, and other variables. Requirements in some countries are comprehensively planned, and plans change with time. Productive absorption of foreign aid depends on the presence of complementary resources such as entrepreneurial talent and skilled labor. As these complements vary, so do capital requirements. Finally, the amount of foreign aid required by the underdeveloped countries is not independent of the supply available and its terms, or the supply they presume to be available. In general, the more there is the more they feel they need. Aid given to some countries prompts others to seek some, or to seek more. Yet each in turn tends to view the external supply with little or no regard to the competitive demands confronting the supplying country. There is, then, an interdependence between "need" and the presumed external supply, and between what one country gets and what another wants. Capital requirements thus tend to become exaggerated and indeterminate.

Although a meaningful measure of capital requirements is difficult to come by, something nevertheless can be said about the adequacy of present external supply and future changes in requirements. Many and perhaps most of the growing but still underdeveloped countries have growth ambitions far in excess of their present rates, and they could productively absorb more external capital at the present time. And these external capital requirements, judged by any reasonable standard of productivity, will grow over the decade ahead.

There are a number of reasons to expect increased external capital requirements over the next decade, and for some time beyond.

First, the relatively rapid growth rate of a developing economy requires increased annual absolute increments of capital from internal and external sources to maintain the rate of growth and to cover the rising volume of capital replacement. At the same time, consumption rises with higher incomes—unless consumption is forcibly held down as it is in the Soviet Union. At any given time, consumption standards limit the resources and funds available for internal capital; to maintain a rapid rate of gross national product growth and to accommodate consumer demands, many of the developing countries will need to rely much more heavily than now on external capital sources.

Second, the political and social forces pushing growth policy are on the rise throughout the world. The "revolution of rising expectations" is well documented; many observers believe that these ex-

¹⁸ Washington Post, Apr. 21, 1959.

pectations must be met within reason to avoid revolution of another order. The pressure for growth, and for the capital essential to it, will build up during the next decade for these social and political reasons alone and it is possible that, unless the free world can rise to the occasion, some of the underdeveloped countries might embrace the Soviet formula for growth and be forced ultimately to accept the political consequences—a strong ruthless Communist party and domination by the Soviet Union.

Third, the world’s “population explosion” is underway. By the year 2000—well beyond the purview of this report—United Nations estimates point to a world population in excess of 6 billion. It was 1.5 billion in 1900; now it is 2.9 billion. However long it has taken the human race to reach its present size, it will take but 40 years to double.

Asia, Latin America, and Africa—the economically less developed regions—will account for most of this impending increase. The expected shift in population can be seen in the following figures on the changing percentage distribution of the world’s population in the next 40 years.

[Percent

	1958	2000
Asia (excluding U.S.S.R.).....	55.2	62
Latin America.....	6.5	9
Africa.....	8.0	8
North America.....	6.7	5
Europe (including U.S.S.R.).....	23.0	15
Rest of world.....	.6	1

Source: Population Bulletin, Population Reference Bureau, Inc., vol. XV, No. 2, March 1959.

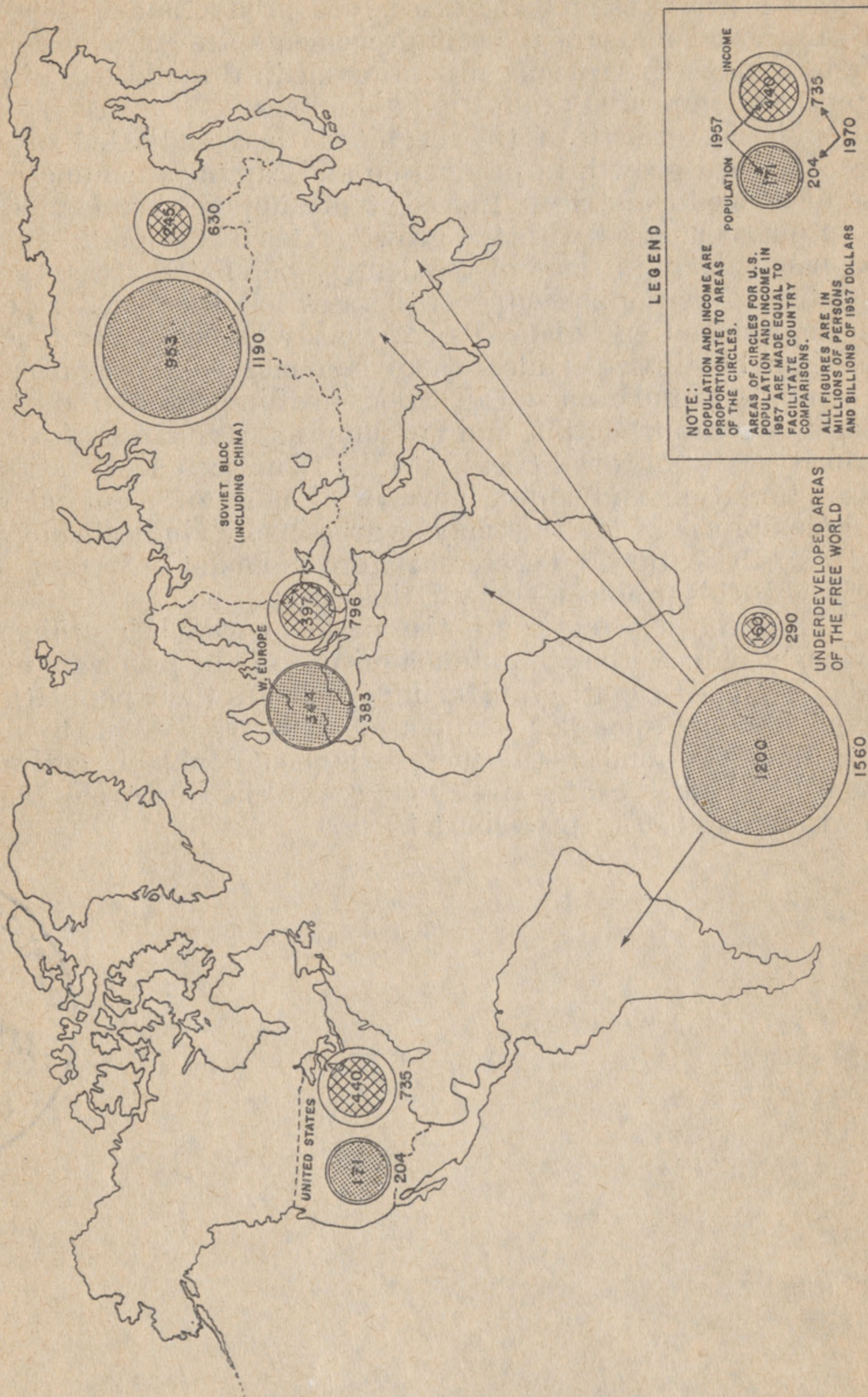
The substantial growth registered thus far in the 20th century has come mainly from the increase in the peoples of Asia and Latin America. Death rates have fallen while birth rates remained high. Decreases in mortality rates reflect the impact of the medical sciences, sanitation practices, and increased food production in these regions. In substantial measure these improvements are contributions of the Western industrial nations, providing medical facilities and training, capital, and improved production techniques.

Population growth of the magnitude here indicated presupposes the continued growth in production and capital accumulation in the less developed countries. Indeed it presupposes accelerated growth in output, compared with the growth rates of the past. In the past and particularly in some of the densely populated areas, the margin of output over population growth rates has been small; per capita consumption, often balanced precariously at bare subsistence levels, has risen but little. Unless there is a marked acceleration in rate of capital accumulation and an extension of improved production techniques, per capita output and consumption standards of the world's majority will improve little, if at all. If no such acceleration occurs, mass starvation and abject poverty of most of mankind are very real possibilities. Malthus may be gruesomely vindicated by the close of the 20th century. The recent Ford Foundation report on India highlights this problem—indeed, this crisis.

Taking the shorter view—the period covered by this report—obviously reduces the absolute magnitude of the problems facing the underdeveloped countries. During the 1960's their population is expected to grow some 360 million, or about 30 percent, to a total of 1.6 billion. In numbers this increase is about double the entire population of the United States and about 20 percent faster than their rapid growth in the 1950's. (See chart 4.)



CHART 4
POPULATION AND INCOME - 1957 - 1970
THE CHANGING WORLD PICTURE



To accommodate this increase, and to provide for an improvement in per capita consumption, is a task of formidable dimensions. It is estimated that 1 percent growth in population per year requires the investment of anywhere from 3 to 4 percent of national income just to maintain the per capita output.¹⁹ Most of the less-developed countries have higher population growth rates—1.5 percent in India, Pakistan, and Ceylon, and 2 percent in most Latin American countries. If such estimates are valid it will take annual investments equal to 5 to 8 percent of their national incomes merely to maintain their growing populations at present consumption standards. Given the prevailing subsistence incomes in the less-developed countries, savings rates of these dimensions are difficult if not impossible to attain, particularly in the heavily populated countries of Asia. If living standards in these countries are to rise even moderately, the increase must be financed heavily by external capital, aided by improved production techniques.

For political, social, demographic, and economic reasons the world is faced with the need for substantially larger annual increments of capital in both the industrial nations and the economically less developed regions. For the latter, the rising expectations, the pressures of political forces, and the sheer mass of growing populations make the situation one of growing urgency, requiring bold long-term cooperative development programs on the part of the industrial countries and the underdeveloped countries themselves to help meet this situation. The challenge is greater than that of rehabilitating Europe at the close of World War II. This challenge must be met to safeguard free world security.

III. PROSPECTIVE CAPITAL SUPPLY

A. GOVERNMENT LOANS AND GRANTS

In recent years government loans and grants for economic aid and technical assistance by nations of the free world have averaged about \$2 billion annually. Somewhat more than half of this has been supplied by the United States, with France and the United Kingdom providing most of the remaining aid funds.²⁰ Part of these funds were for defense support activities and this directly contributed little to economic growth. In addition, international agencies lent and granted over \$800 million during the years 1954–57. This latter source is expanding. In 1958 World Bank loan disbursements alone reached \$500 million and are expected gradually to increase.

In this same period (1954–58) the Soviet bloc extended credits and loans for about \$2 billion, although disbursements under these agreements have probably not averaged above \$250 million a year. The bloc gives only negligible sums as grants.

Loans and grants made by France, the United Kingdom, and Belgium go mainly to the French African regions, the Commonwealth, and Belgian colonies, respectively. U.S. loans and grants are more widely diffused over the world.

¹⁹ W. Brand, "The Struggle for a Higher Standard of Living," the Free Press, Glencoe, Ill.

²⁰ Statistical Yearbook, 1958, the United Nations.

The extent to which governments provide capital through loans and grants depends on political policy and economic capability. For the European countries, including the United Kingdom, policy focuses largely on forging closer economic and political bonds with the overseas spheres—the colonies, former colonies, and promising sources of important raw materials. Economic capability depends on the country's economic base and its international financial position. Western Europe in this respect is now strong again; as a region it is likely to match and possibly surpass the United States within a decade. Thus the foreign aid capabilities of Western Europe will grow steadily; a twofold or threefold increase in loans and grants over present amounts in the next decade is within reason. Its selective investments, however, leave large parts of the underdeveloped world untouched. Political, and even economic, selectivity reduces opportunities for useful cooperation through regional developmental undertakings.

Since the free world faces a common threat from the designs of communism, it may be suggested that U.S. policy should, in this and other directions, work with vigorous initiative toward a common strategy along these lines (*a*) to expand our own activities in the struggle by assuming the role of good banker to the underdeveloped countries; (*b*) to urge an increase in governmental aid from the allied nations; (*c*) to induce countries not now sharing in this work to participate; (*d*) to foster a greater degree of cooperation among the capital exporting countries and the underdeveloped countries themselves in formulating ambitious, sound developmental plans, policies, and projects; and (*e*) to associate in greater measure private investment with free world policy purposes.

The position of the United States as a supplier of capital is undergoing a basic change. As West Europe and Soviet foreign aid capability promises to grow, ours will have to change its form. There are financial limits to a foreign aid policy, set not only by budget considerations but also by the balance of payments and internal financial stability. There are two aspects involved here. Economic aid might add to current deficits in the balance, but if it takes the form of long-term loan financing future repayments and interest will help finance the future growth of U.S. imports.

Briefly, to anticipate later discussion, the United States provides dollars to foreigners mainly by (*a*) the purchase of imports and services, (*b*) investing abroad, and (*c*) by Government loans and grants.

Foreigners use these dollars mainly to (*a*) buy U.S. exports and services, (*b*) invest in U.S. securities and build up dollar balances, and (*c*) purchase U.S. gold.

Over the past 9 years the United States has exported goods and services to foreign countries far in excess of foreign earnings from sales to the United States. Yet our aid programs and foreign investments have more than financed the foreign dollar deficit to the extent of over \$13 billion. That is, our balance-of-payments deficit after we have paid our aid and investment dollars has averaged \$1.5 billion per year. This has been used to build up dollar balances and to buy gold, mainly by Western Europe. U.S. policy sought to rebuild Europe's dollar balances. The Marshall plan and the mutual security programs have helped to accomplish this financial objective. In-

deed, if we care to look at it that way, Europe's recovery over the whole postwar period has in fact mainly been accomplished by her own resources. We simply provided the working capital and bridges over the difficult early years and over foreign exchange imbalances.

Conceivably, foreign countries will continue to build up their dollar balances (i.e., in effect to invest in the United States) or to import U.S. goods and services, but they might not. The decision is theirs, not ours. If the erstwhile "dollar shortage" in Europe is replaced by a "dollar glut," the United States obviously would find it difficult to continue its substantial foreign commitments there unless it pays in gold. Economic aid to the underdeveloped countries, however, is in a different category. Conceivably, developmental loans to them could be tied to U.S. capital goods exports, with little or no pressure on our balance of payments. Such a policy, however, would raise other problems. It would increase the cost of capital to the borrowing countries by restricting choice and raise innumerable international political difficulties. Such a policy, therefore, should be considered only as a last resort. First and foremost we should avoid the need for it by maintaining the internal conditions essential to confidence in the dollar.

The international economic environment is changing. A basic shift in the economic and financial distribution of power is underway. In terms of meeting the expanding capital requirements of the underdeveloped countries, Europe's role should grow in absolute and relative importance. So might that of the Communist bloc. In the one case this is to U.S. advantage. In the other, it is not, unless the United States and the allied nations build a development program such that Soviet aid can provide only a part, and not a major part, of the total investment for these countries. The framers of U.S. foreign policy over the next decade must take the good and the bad into account in a context which, unlike that of the recent past, is much more demanding in its requirements for exactly the right quantitative and qualitative decisions in foreign aid programs.

B. SOVIET ECONOMIC AID

By the end of 1958 the Soviets had signed economic aid agreements with underdeveloped countries for a total of \$2.1 billion. The facts relating to disbursements under these agreements are not clear, but disbursements are estimated at less than \$900 million.²¹

While U.S. Government aid is much larger, Soviet aid concentrates in some areas where there is relatively little private U.S. investment to help the growth process. These areas are short on management skills and techniques in such fields as industry and power. The aid recipients get little of these skills and techniques from the U.S. aid programs and almost none from private investors. Soviet engineers and industrial technicians are a part of Soviet aid, which stresses industrial and related projects. Where the ideological struggle is the keenest, the driving force of U.S. enterprise is often lacking and the Soviets are able to reap large political gains at relatively little expense.

The Soviets can, and probably will, increase their aid to these countries in the industrial sectors favored by the underdeveloped countries. Moreover, the U.S.S.R. has tended to combine aid with future

²¹ Wall Street Journal, June 26, 1959.

trade in their repayment provisions. They provide both the production facilities and a market to the recipient countries in many instances. The future course of Soviet aid depends on policy considerations and economic capability. Their policy position seems clear—they want a larger role. As for capability, this is likely to increase as their production grows. Policy and capability determine the supply side of the matter; the demand—willingness—of the underdeveloped countries will be influenced by the amounts and terms offered by the industrial nations of the free world as well as by our fundamental attitudes toward their economic growth programs and by the means they employ to implement those programs. If the price of our aid is to make those countries over in our image, their readiness to look elsewhere, where they will be encouraged to undertake bold new programs of ambitious development through complete economic planning, will be enhanced.

C. PRIVATE INVESTMENT

It is official U.S. policy to encourage private investment abroad, portfolio and equity, and official statements increasingly indicate that private U.S. investment should play the major role in international economic development. This view arises in part from a desire to reduce the burden of Government aid and in part from a nostalgic belief that the U.S. private enterprise system offers the most effective way to achieve economic growth regardless of the environment or the availability of human and national resources.

This position as it presently stands has its limitations. In terms of U.S. aid policy, private U.S. investment abroad is highly selective. It tends to favor the more developed and to ignore the more backward areas, unless nature by chance provided them with petroleum or mineral resources. Adverse government policy in many areas also leads to their avoidance by U.S. investors.

Selectivity is even more pronounced with portfolio than with direct investment, due largely to the painful past experiences of U.S. investors. In the postwar years, only the Western European countries, Israel, and those of the British Commonwealth have been successful in floating sizable bond issues in the United States. There may be some slow relaxation in the attitudes of the U.S. capital market as policy and economic conditions elsewhere improve, but the likelihood is small that there will be more than a trickle of sales of public issues for the more underdeveloped areas in the next decade.

As of the end of 1957, the book value of U.S. direct private investments abroad came to \$25.3 billion. Of this total, about half, or \$12.3 billion, was in Canada and Western Europe. In the countries of Latin America and the Middle East, to take two major underdeveloped areas, total private direct investment amounted, at the end of 1957, to \$8.8 billion but, of this total, \$5.6 billion, or 63 percent, was in the extractive industries—petroleum, mining, and smelting. These extractive industries, with their associated industrial processing, contributed to economic growth and development in the countries concerned. But again, within the geography of Latin America and the Middle East, such investments were concentrated in four or five countries. This is typical of the selective pattern of international private investment, caused by differences in economic opportunity and the investment climate in the underdeveloped areas.

In the years from 1955 to 1957, about half of the increase in U.S. direct foreign investment went to Canada and Western Europe. With the steady expansion of the economies of Western Europe, and the continued growth of Canada, it appears probable that an increasing share of such investments will go to the developed rather than to the underdeveloped areas of the world. However, the latter areas will undoubtedly gain in absolute amount on a selective basis, depending on economic opportunity and the policies of the foreign governments. Selectivity is wholly understandable; business executives are obliged to exercise discretion. In the absence of special inducements and guarantees, the more backward areas will be avoided.

Much tribute has been paid by the Government to the need for increasing the volume of foreign investments, and the agencies of the U.S. Government which do foreign financing have, of course, been continuing and even expanding the U.S. role in world economic development.

During the period from 1952 through 1958, the Export-Import Bank made loans of \$4.6 billion. Associated U.S. equity capital, however, amounted to only \$265 million, or to less than 6 percent. Of the loans of \$812 million made by the Development Loan Fund through June 30, 1959, about 10 percent have gone directly to private projects overseas, and another 24 percent have gone into private projects through Government channels. The Cooley amendment loans to private enterprise, although in operation only since August 1957 have, however, been especially utilized in the least developed areas, which have received the bulk of such loans from surplus commodity proceeds. The investment guarantee program has accounted for some \$400 million of private investment in the years of its operation—much of it in the Western European countries.

The countries of Western Europe, long associated with colonial development, have been important sources of private capital for most areas of the world for many generations. Their long experience and tradition in this field will make of them major and often competitive sources of private financing in both the developed and the underdeveloped areas of the world. On the other hand, their own capital needs for continued economic growth and expansion will be great, so that there will be balancing forces at work. Their private investments overseas are likely to be influenced by political as well as economic considerations, and hence will tend to go, as they have done in the postwar years, to their own colonies or areas of influence. Hence, large portions of the world will have access to only relatively small private investments from the European countries.

Of the total of \$3.8 billion included in the international flow of private capital in 1956, of which reinvested profits constitute a part, over 33 percent was invested in Canada so that this 1 country of 17 million persons received about as much private external capital as the 20 countries of Latin America combined, with about 10 times the population.

IV. CONCLUSIONS

A. PATTERNS OF CAPITAL FLOW

1. Non-U.S. foreign government loans and grants concentrate in areas of political influence, such as the Commonwealth or the French Community. This flow can and undoubtedly will increase.

2. Non-U.S. foreign private investment to underdeveloped countries tends to follow the direction taken by Government financing, and within these bounds, concentrates in the most promising places—for example, private British investors favor India. Undoubtedly these investments will grow.

3. Most U.S. private foreign investment goes to developed countries, and the balance goes selectively to (a) a few rapidly developing countries, mainly in Latin America, and (b) the oil-and-mineral-rich regions. These investments will probably increase in line with present patterns.

4. The U.S. Government is, in a sense, left with the rest—the least promising places from the investment point of view. At the same time it contributes substantially to other, more promising countries, such as India.

5. The private patterns of investment are understandable; important as their efforts are, private investors are not in the business of economic development per se. Development is a byproduct. If private investment is to go to areas, and for purposes, important to U.S. foreign policy, specific incentives will need to be devised for specific purposes.

6. Both the needs for capital in general and the present patterns of supply to the least developed countries make many of them vulnerable to Soviet advances—and some acutely so.

7. The Soviet pattern of economic assistance is highly selective at present, concentrating on areas having difficulties of one sort or another with the West and on those in which neutralist tendencies are strong or where the U.S.S.R. wants to promote such tendencies.

B. SOME POLICY IMPLICATIONS

1. U.S. policy might well seek to fashion a common strategy with Western Europe for the international allocation of public capital and for providing inducements to private capital to flow to the underdeveloped areas, in recognition of the Communist threat. It seems clear that the Communists themselves are deploying their external resources in accordance with a strategic plan.

2. U.S. policy emphasis on the encouragement of private investment abroad needs a critical review. There is no need for special incentives, such as tax concessions, to encourage investment in profitable ventures in countries with good investment environments. For example, the Common Market tariff discriminations seem likely to be incentive enough for the migration of U.S. private capital to that area. To consider across-the-board incentives as a means of stimulating private investment in the underdeveloped countries may be less effective than specific measures limited to specific situations.

3. As a means of encouraging private investment in the areas now bypassed, CEIR suggests that the Development Loan Fund direct

more of its energies and resources to the promotion of private investment in areas important for foreign policy purposes but normally bypassed by private investors. U.S. firms might be encouraged to establish affiliates, under business ownership and management, with funds borrowed from the Development Loan Fund but secured by the affiliate property to minimize private risk. Training and technical assistance in the industrial arts should go hand in hand with such financing, perhaps on a contractual basis using funds derived from the sale of surplus agricultural commodities.

4. Multinational means of raising capital and guiding investment programs need further and continued support. The World Bank, and on a regional scale the Inter-American Development Bank, are effective and advantageous techniques. Government-to-government economic aid arrangements are often mutually exacerbating. When there is no specific policy problem involved, these multinational organizations may be more effective vehicles for financing developmental projects than direct Government aid. Being joint enterprises with joint responsibility, they tend to inculcate understanding and discipline among their members, including those who receive the assistance.

C. LONG-TERM PROBLEMS

Over the next decade, and beyond, U.S. foreign policy will continue to face the problem of insuring adequate economic aid to the underdeveloped countries. Whatever turn policy may take, the fact is these countries are there, with their poverty, aspirations, political unrest, and varying degrees of growth potential. We have termed them the vulnerable parts of the world. At one time this problem could be ignored with impunity. It no longer can, with Soviet economic strength growing and its designs clearly written.

While the problems cannot be ignored, getting involved is no guarantee of success. In some cases weak and inexperienced governments, or worse, will frustrate efforts to achieve economic progress. In some cases, economic viability is extremely difficult, given the geography and resources. Or the cultural barriers may resist change, or distort it. In short, a policy of growth involves a gamble; in some places it might not work. Withdrawal of help in such cases involves a gamble of another sort—a possible Communist gain through default. The risk of failure inherent in aid programs could be reduced by combining with aid the powerful inducements of trade.

The United States and its North Atlantic allies must face up squarely to the problem of providing capital to the underdeveloped countries to support a program of "growth with consumption." Tolerance and flexibility in dealing with these countries are prime necessities; complete coordination and initiative in bringing together the developed and underdeveloped nations to insure the forward economic march of the free peoples of the world, are even more important. The free world has the resources; it has the will to win if aroused; it has any number of international and national agencies to implement sound programs. What it lacks is first, a cooperative, long-range, economic development program, and second, a sense of urgency commensurate with the growing problem now confronting us. These gaps must be filled.

CHAPTER 3

INTERNATIONAL COMMODITY FLOWS AND TRADE TRENDS

I. INTRODUCTION

Commodity flows and world trade trends in general suggest the nature of some of the problems and tensions looming ahead. The underdeveloped countries have a large stake in the course of their trade during the next decade; trade partly determines their capacity to grow. Trends in U.S. trade and in the U.S. balance of payments are important as elements shaping this country's international role in the future. Trade patterns have changed during the 1950's as the Western European countries have resumed their dominant role in world trade. New elements will likely appear. The Soviets seem ready to bid for a much larger share of trade with the free world, and Communist China could become a major factor in Asia under the pressures to trade arising from its development program.

The trade patterns of importance here are those in the basic commodities and in the trading relations of the industrial and non-industrial nations. These patterns are summarized below for 1957. Then some past and probable future trends will be discussed, followed, in chapter 4, by a review of trade and payments trends for the United States.

II. WORLD COMMODITY FLOW PATTERN, 1957

The export of primary commodities—foodstuffs, industrial raw materials—bulks large in the trade of the underdeveloped countries, ranging from 60 to 80 percent of their total exports. Most of this trade is with the industrial nations, of which the United Kingdom and other Western European countries are the principal importers. Primary commodities thus earn the underdeveloped countries most of their foreign exchange.

In part, the development programs of these countries depend on such exchange earnings to purchase essential capital goods from the industrial nations. Historically, the prices of primary commodities have fluctuated quite widely, causing substantial changes in foreign exchange earnings. Such fluctuations can be disruptive for development programs, unless the developing country can accumulate reserves of foreign exchange to offset the effect of variations in receipts.

The extent of reliance on primary commodities, by major regions, is summarized in the series of tables below.²²

A. EXPORT PATTERNS: THE UNDERDEVELOPED REGIONS

1. *Latin America*.—Basic commodities accounted for 80 percent of Latin American exports in 1957.

TABLE 4.—*Basic commodity exports, 1957: Latin America*

Commodity	Major commodity exports, 1957 percent of total export trade
Coffee	18.2
Crude petroleum	13.4
Sugar	10.4
Petroleum products	10.2
Ores and nonferrous metals	7.7
Meat	3.4
Fruits and vegetables	3.3
Cotton	3.0
Iron ore	2.8
Wool and hair	2.7
Other	4.2
Total major commodities	79.3

The United States imported 46 and Western Europe 42 percent of these commodities. Crude petroleum, petroleum products, coffee, and sugar made up half of Latin American exports of basic commodities. Ores and nonferrous metals are growing in importance as Latin American exports, with the United States the major and a growing market. U.S. quotas on petroleum and certain nonferrous ores and the disposal of surplus cotton have caused considerable difficulties in Latin American countries affected by these policies.

2. *Africa and the Middle East*.—This region is similarly dependent on primary commodity exports which earned it nearly 80 percent of its foreign exchange in 1957.

²² The year 1957 was chosen as the latest year for which reasonably complete information is available. For purposes of this study, CEIR constructed import commodity flow grids, export commodity flow grids, and commodity surplus and deficit tables. The main data sources are: "Commodity Trade Statistics, January–December 1957," published by the United Nations; Foreign Trade Statistics of the U.S. Department of Commerce; and the "Statistical Handbook on Foreign Trade of the U.S.S.R., 1957," an official Soviet publication. Additional data from the following United Nations 1958 publications were used to supplement the above: "Economic Survey of Latin America, 1957"; "Economic Survey of Europe, 1957"; "World Economic Survey, 1957"; "Economic Survey of Asia and Far East, 1957"; and "Yearbook of International Trade Statistics, 1957." Other supplementary data sources are: "Commodity Survey, 1958," United Nations, 1959; "Mineral Resources of and Background Information in the Eastern Hemisphere," U.S. Senate, Committee on Interior and Insular Affairs, December 1958.

TABLE 5.—*Basic commodity exports, 1957: Africa and the Middle East*

<i>Commodity</i>	<i>Major commodity exports, 1957 percent of total export trade</i>
Crude petroleum-----	31.6
Cotton-----	7.3
Fruits and vegetables-----	4.9
Nonferrous metals-----	4.9
Coffee-----	4.8
Oilseeds-----	3.9
Ores and concentrates-----	3.9
Cocoa-----	3.5
Petroleum products-----	2.9
Iron ore-----	2.4
Other-----	8.8
Total major commodities-----	78.9

Some 70 percent of the region's largest export, petroleum, goes to Europe. As a whole, Western Europe purchases three-quarters of the region's exports, the United States 10 percent, Japan 6 percent, and the Soviet bloc 4 percent.

3. *Other Asian countries and Oceania.*—This area (excluding India and Communist China) is dependent upon basic commodity exports for 65 percent of its foreign exchange earnings. Wool is the major export item, 70 percent of which is sold to Europe and 16 percent to Japan. Europe imports over 40 percent of the rubber exports, the second largest foreign exchange earner for the region. Again, Western Europe is the principal market for the exports of this region, purchasing some 57 percent of the total in 1957. The United States and Japan took 17 and 16 percent, respectively.

The pattern of Indian trade differs considerably from that of the region as a whole. Primary commodities account for only 45 percent of her exports, nearly half of which is tea.

TABLE 6.—*Major commodity exports, 1957: Other Asian countries and Oceania*

<i>Commodities</i>	<i>Major commodity exports, 1957 percent of total export trade</i>
Wool and hair-----	18.4
Crude rubber-----	13.1
Meat-----	4.5
Sugar-----	3.2
Oilseeds-----	3.1
Ores and concentrates-----	3.1
Nonferrous metal, of which tin is 1.7 percent-----	2.8
Butter, cheese, and curd-----	2.6
Tea-----	2.1
Jute-----	2.1
Crude petroleum-----	1.8
Wheat and wheat flour-----	1.2
Fruits and vegetables-----	1.2
Iron ore-----	1.0
Other-----	3.8
Total major commodities-----	64.0

Unlike the rest of this region, India's imports of primary products are increasing, principally wheat and flour. In contrast, India exported wheat at the turn of the century, a dramatic index of the rise of her population.

B. SOME GENERAL FEATURES

With few exceptions, such as New Zealand and Australia, the regions discussed briefly above comprise the free world's underdeveloped areas. There are vast differences within these regions, ranging from sparsely settled arid lands to densely populated tropical areas. Some are industrializing at a rapid rate, others have hardly begun, and in some industry does not seem likely to develop.

In varying degrees these regions depend heavily on primary commodity exports. Their primary commodity imports average under 10 percent of total imports, again with some exceptions, such as India. Their exports of primary commodities go to (1) Western Europe, (2) the United States, (3) Japan, and (4) the Soviet bloc. The bloc is a poor fourth and Europe is in first place by a substantial lead, taking some 60 percent of the primary commodity exports of these regions.

These major markets hold the answer to the prosperity of the non-industrialized areas over the next decade. Substantial growth in Western Europe, the United States, and Japan will cause expansion of the trade between them and the nonindustrial countries. Soviet industrial expansion can be expected to open up additional markets for these primary goods producers. The extent of such Soviet trade will depend upon many things including: (1) the import policies of the industrial nations, (2) their rate of production growth, (3) U.S. primary commodity production and export, (4) Soviet industrial growth, its economic requirements, and its political objectives.

Primary commodity exports and their prices are generally sensitive to changes in output and income in the industrial nations, and to changes in the import policies of these nations. The "chronic problem" of the primary commodity producers is the instability of foreign exchange earnings. They normally maintain minimal balances of gold and exchange and consequently a drop in earnings creates a foreign exchange crisis accompanied by internal unemployment. These familiar phenomena lend attraction to commodity stabilization schemes of various types. The causes of their exchange problems, however, are not confined to the inherent instability of the prices of their primary exports. Internal policies frequently compound their difficulties by stimulating growth in supply of their staple exports, thus depressing prices, or by stimulating excessive investment programs which cannot be financed by the investment resources available.

As in the past, so in the future, the primary commodity producers in the underdeveloped regions will face periodic exchange crises which will exacerbate their long-term chronic shortage of foreign exchange. In the absence of accumulating their own reserves, some method of handling the periodic exchange crises must be worked out. This could be done for the recurring, temporary, or cyclical shortages of foreign exchange by increasing the resources of the International Monetary Fund by two or three times and liberalizing member drawing rights. This would insure an automatic source of funds in ample amount to handle emergencies. The chronic long-run problem, however, cannot be solved by this means.

C. THE INDUSTRIALIZED COUNTRIES AND COMMODITY TRADE

1. Western Europe as a region is negligible as an exporter of primary commodities. Primary commodity imports, however, comprise 40 percent of the total imports of this region; and these imports supply a substantial part of the foodstuffs, fuel, and raw materials essential to the life of the west European economy as a whole.

The sources of Western Europe's primary commodity imports in 1957 are shown below.

	<i>Percent</i>
Africa and Middle East.....	30.7
United States.....	20.4
Other Asian countries and Oceania.....	18.7
Latin America.....	18.0
Canada.....	5.7
U.S.S.R.....	1.9
European satellites.....	1.7
Communist China.....	.3
India.....	2.5
Japan.....	.1
Total.....	100.0

2. Japan is rapidly expanding its role as an importer of primary commodities and an exporter of industrial products; indeed it must to exist and grow. The free world must realize that Japan's only recourse, if shut out from her markets in the United States and Europe, would be to seek her raw materials and markets elsewhere. And this could mean resumption of her trade with China and a much closer economic relationship with the Soviet bloc. In 1957, primary commodities accounted for 63 percent of its imports and less than 2 percent of its exports. Regional sources of Japanese imports of primary commodities are shown below.

	<i>Percent</i>
Other Asian countries and Oceania.....	33.2
United States.....	27.2
Africa and Middle East.....	15.1
Latin America.....	11.1
Canada.....	5.1
India.....	3.2
Communist China.....	2.6
Western Europe.....	2.1
U.S.S.R.....	.4
Total.....	100.0

Japan formerly traded substantially with China in raw materials, but it now trades mostly with south and southeast Asia and the United States. Mainland China could reemerge as a major Japanese supplier and market if other markets become unduly restrictive. Japan, like the United Kingdom, must "export or die," and the national interest of the United States requires that we avoid trade restrictions in our response to the success of Japan's efforts to expand her exports to the U.S. market. This expansion is necessary to pay for the increasing amounts of raw materials, fuel, and manufactured goods Japan will want to buy from the United States and which U.S. producers naturally want to sell to Japan.

3. The United States, unlike any other major country or regional grouping, is both a large exporter and importer of primary commodities. In fact, it is the world's largest single trader in these commodities.

In 1957, primary commodities accounted for 29 percent of U.S. exports, with coal and coke, cotton, wheat and wheat flour comprising about one-half this category of exports.

Western Europe is this country's best customer; in 1957 this area took nearly 60 percent of U.S. primary commodity exports, with Japan in second place at 12 percent.

U.S. surpluses, particularly in cotton and wheat, and their disposal in the world market, raise special problems. Large-scale production, the building up of stocks, and sale abroad for local currency, combine to depress world prices in these two major export commodities. Brazilian and Asian cotton exports and earnings have been adversely affected by the surplus disposal program which has financed 30 percent of U.S. cotton exports in recent years. Canadian and Australian wheat exports have been hurt by the surplus disposal program, which has penetrated into new markets such as Brazil, India, Pakistan, Africa, and the Middle East. The political tensions and frictions resulting therefrom are well known and need no elaboration.

The outlook holds no promise of relief. The United States is a highly efficient producer of these and other crops, and surpluses appear unavoidable for years to come. Farm policy, however, and the surplus disposal program, need a careful examination from the foreign policy point of view. Agricultural policy has been singularly inept on this point for the last 2 decades. Foreign markets have been lost only to be recovered and expanded by a disposal program which, if applied by others in competition with us, would earn these countries the wrath of Congress, farmers, and the public at large. Our domestic producers must recognize that short-sighted policies jeopardize our foreign policy by disturbing relations with allies and damaging their economic positions.

On the other hand, the disposal program has been a boon to India, Pakistan, Brazil (for wheat but not cotton), Spain, and many other major importers. As essentially a year-to-year salvage operation it has had foreign policy advantages in certain directions. Whether these offset the damage done to our relations with allies hurt by the program is an open question.

There is a continuing problem here. Perhaps the sale of surpluses for local currency is here to stay for some years. If so, foreign policy considerations suggest a cooperative policy and program with the other major exporters in place of our go-it-alone approach.

Imports.—Some 55 percent of U.S. imports in 1957 were primary commodities. Of these coffee accounted for nearly 20 percent, followed by petroleum, petroleum products, ores, concentrates, and non-ferrous metals.

The U.S. industrial system is becoming increasingly dependent upon foreign materials, particularly petroleum, ores, and metals. Petroleum imports are likely to expand as a share in U.S. consumption. Bauxite imports furnish four-fifths of U.S. consumption; by 1970, predicted increases in imports range from 200 to 300 percent to meet the expected growth in the aluminum industry. Manganese and chrome imports in 1957 supplied nearly 90 percent of U.S. requirements. These imports are expected to increase some 40 percent by 1970, in keeping with the expansion of the iron and steel industry. Iron ore imports from Latin America and Canada are large and could double or more by 1970.

Imports of the following commodities account for two-thirds or more of U.S. consumption: nickel, tin, fluorspar, artificial abrasive, tungsten concentrates, asbestos, mica, cobalt, platinum metals. There are others as well. Copper, zinc, and mercury imports supply between 35 and 55 percent of U.S. requirements. In some of these products the United States has shifted from a net exporter to a net importer and from a low-cost producer to a marginal producer. And it takes quotas and tariffs in some instances to maintain even the marginal-producer status.

The principal U.S. suppliers in 1957 were as follows:

	<i>Percent</i>
Latin America-----	51.7
Canada-----	18.3
Other Asian countries, Oceania-----	12.7
Africa and Middle East-----	9.4
Western Europe-----	6.4
India-----	1.0
Soviet bloc-----	0.4
Japan-----	0.1
Total-----	100.0

For virtually all the commodities in the category under discussion (some 55 percent of all imports) future requirements will rise. About half this category—petroleum, iron ore, manganese, other nonferrous metals—will rise faster than the prospective growth in the U.S. gross national product. The growing dependence of U.S. industry on foreign sources of supply underlies in large measure the predictions of those who expect U.S. imports gradually to rise in relation to national income—from about 3 percent recently to nearly 3½ percent or more when gross national product nearly doubles its 1957 volume.

III. TRENDS IN TRADE AND OUTPUT

During this century, world trade has grown on the average 3.4 percent annually, while world manufacturing activity has increased about 4.1 percent annually. For the early postwar years, the rates accelerated to 7.5 and 6.1 percent, respectively. As for the future, the International Monetary Fund concludes that “it would probably not be overoptimistic” to expect a future annual growth rate in trade of 3 percent per annum. This actually might be somewhat pessimistic in view of the prospective growth in production.²³

Trade trends for the industrial and nonindustrial nations are important for assessing the future growth prospects of underdeveloped countries. The General Agreement on Tariffs and Trade study, “Trends in World Trade,” showed that the exports of the underdeveloped countries in recent decades have grown less than those of the industrial nations. From 1928 to 1957 exports from the industrial nations of the free world rose 62 percent and from the nonindustrial countries (non-Communist) 51 percent.

²³ Triffin, Robert, Banca Nazionale del Lavoro Review, Rome, March 1959, pp. 31–34.

The share of the nonindustrial nations in world exports has therefore decreased, although their share in world imports has increased. The figures (excluding petroleum exports) are as follows:

[Percent]			
	1937-38	1953	1957
Exports.....	31.2	30.4	25.0
Imports.....	27.8	30.7	30.7

Petroleum exports come from countries with only 10 percent of the population of the less-developed portions of the world. By adding in petroleum, the percentages rise to 34, 36, and 32 for the years shown above.

The relative decline in the exports of the less-developed countries is explained by (a) the great expansion of U.S. trade postwar, (b) manufacturing shifts toward types of output requiring less imported raw material, (c) development of synthetics in the industrial nations, (d) increased manufacturing in such countries as India and Brazil, using their own materials to produce end products, (e) the low income elasticity of demand for foodstuffs, and (f) protectionist policies in the industrial and in the underdeveloped countries.

The General Agreement on Tariffs and Trade experts also found that the imports of the United States and Western Europe from the underdeveloped countries have declined in relation to national income over the last 30 years: from 3.5 percent of combined gross national product to less than 2.5 percent (excluding petroleum) at present. Over the same period the lag in underdeveloped country exports has been accompanied by a relative increase in their imports.

Looking into the future, the General Agreement on Tariffs and Trade study is somewhat pessimistic. On the basis of past trends the study concludes that (a) the import requirements of the less-developed nations are likely to grow more rapidly than the rest of world trade as development plans are pushed, and (b) their exports are likely to increase less than the rest of world trade. As shown above, these exports are predominantly primary commodities. These future trends, if they materialize, spell continuing difficult problems unless the industrial nations fill a growing gap with increased public capital and the developing nations attract more private foreign investment.

The staff of the Economic Commission for Europe²⁴ projected imports by Western Europe and North America of foodstuffs, raw materials of agricultural origin, and minerals, ores, and base metals. Even assuming fairly high rates of growth in the industrial nations, the ECE staff concluded—

the annual rate of growth in the volume of their imports of agricultural products would amount to no more than 1.5 to 2 percent, and for the major commodity categories even less. A growth in the domestic output of the exporting countries at such low rates would in many cases not even allow the maintenance of per capita real incomes.

The Economic Commission for Europe staff further contends that—

For the bulk of the population of the underdeveloped areas exporting agricultural products, other than coffee or rubber, the prospects of economic development

²⁴ Economic Survey of Europe in 1957.

following an expansion of their trade are very unfavorable indeed. A rise of 80 to 100 percent by 1975 in the gross national product of North America and Western Europe would probably lead to a rise of less than 50 percent in their imports from the major agricultural exporters.

Taking all primary commodity imports the rise would amount to 75 percent, assuming gross national product rose in North America by 80 percent and in Western Europe by 100 percent. If Western Europe's gross national product increased only 60 percent, such imports would rise by only 50 percent. These projections reflect a decreasing ratio of primary commodity imports to gross national product.

In general, the underdeveloped countries relying heavily on agricultural exports stand to gain less from the growth of the industrial nations than do those exporting metals and ores. Taking CEIR's gross national product projections, the order-of-magnitude increases of the industrial nations' imports by 1970 are: (a) 35 to 45 percent for agricultural commodities, and (b) 125 to 150 percent increase in ores, base metals, and petroleum.

Countries exporting ores, concentrates, base metals, and petroleum, however, have only one-third the population of those whose export prospects are less favorable. This underscores the familiar fact that both trade and growth rates differ materially among nations, and probably will continue to do so. On trade prospects alone, development will be uneven. In general, both the General Agreement on Tariffs and Trade and the Economic Commission for Europe experts take a somber view of the prospects for the underdeveloped countries.

In CEIR's view, this pessimism may be exaggerated, for a number of reasons:

1. The trade projections above show a greater rate of growth than does population in the underdeveloped countries. To the extent that earnings from foreign trade influence internal growth, production should keep ahead of population on that count alone.

2. While earnings from foreign trade do influence economic growth, this influence generally is supplemental to the more important internal forces and policies that make for economic growth.

3. For many countries the present structure of their primary commodity exports need not be the pattern for the future. For example, India's tea exports might increase foreign exchange earnings very slowly in the years ahead, but the development of its rich iron ore reserves promises substantial export earnings in the future.

4. In some cases the internal development of new primary resources would free an underdeveloped country from dependence on foreign sources, thus saving foreign exchange for capital goods imports. For example, if the petroleum resources of Brazil and Argentina were developed, more of their foreign exchange earnings from the export of coffee and meat could be put to other purposes.

5. Primary commodity exports are not the only means of acquiring foreign exchange. The export structure can change gradually and often will in the process of economic growth. Over the last 20 years, eight underdeveloped countries (including Argentina, Brazil, Mexico, India, Pakistan, the Union of South Africa) have increased the proportion of their manufactured goods to total exports from 16 to 21 percent. Foreign investments in the future should speed up this shift in export composition and enable some savings of foreign exchange to occur at the same time. Indeed, in some crowded coun-

tries, such as India, a shift to exportable manufactures may make considerable economic sense. Agricultural development is costly under crowded conditions and would displace large numbers of farm laborers, involving additional costs. A comparable investment in exportable manufactures might pay off in terms of relatively greater imports of foodstuffs purchased with the proceeds.

6. Finally, the volume of primary commodity imports into the industrial nations could increase through the liberalization of present import restrictions. Western Europe is the principal importer from the underdeveloped countries and generally imposes fairly high duties, purchase taxes, and other controls. The United States is the second largest market with a trend toward increased restrictions. Policy is thus important. Liberalization of import restrictions would gain the industrial nations cheaper raw materials which would foster more rapid economic growth for them, ease the exchange problems of the supplying countries in varying degrees, and make both parties better customers. Of course, trade liberalization brings its own internal problems, some of which are serious. But restrictions can also backfire, defeating the purpose they are intended to serve. Dairy and other restrictions here, for example, encourage substitutes which have taken a good share of the markets from the "protected" industries. At times protection can fail to protect.

IV. COMMUNIST BLOC COMMODITY TRADE

The coverage of the Communist bloc commodity trade is incomplete. Considering the total trade of the U.S.S.R., this can be said: (a) three-quarters of it is with other members of the Communist bloc, the bulk of which is with the European satellites; (b) Soviet trade is expanding rapidly; (c) the unbalanced economic growth in the Soviet economy puts pressure on it to buy from abroad and to export to cover the cost; (d) about half the trade outside its orbit is with Western Europe (and Yugoslavia); (e) the United Arab Republic and India are the most important two-way trading partners (and the areas of Soviet political courtship) outside Western Europe, while Cuba, Malaya, and Iran are substantial suppliers to, but not importers from, the U.S.S.R.; (f) in 1957 Soviet trade with the non-Communist world approximated \$1 billion, about 40 percent of which was in primary commodities. About 74 percent of its exports of primary commodities to the free world went to Western Europe; about 12 percent went to the United Arab Republic. Grains, coal and coke, and petroleum are the main exports.

The European satellites contribute little to the free world imports of primary commodities. Their exports go mainly to the U.S.S.R. Coal and coke are the only important exports to Western Europe in this category.

Communist China's primary commodity exports are sent largely into the U.S.S.R. with most of the remainder going to other Asian countries. Potentially a large trader, China at present is only a modest factor in world trade.

At the present time, the Soviet Union is not a dominant factor in the important primary commodity markets. However, it is not without its economic influence; for example, whether it buys much or little natural rubber will affect the world price of this volatile com-

modity. Except for selected countries and selected commodities it plays a minor role.

As discussed earlier in this report, the Soviet's role in trade will probably expand significantly. For much of its history autarkic policy limited drastically its trade potential, possibly to its economic disadvantage. Under the post-Stalin regime this has changed. Political motives alone do not provide an adequate explanation of this shift. At this stage in its development, trade expansion for economic reasons seems essential—under any regime this would occur. But the U.S.S.R. is not above taking political advantage of its commercial needs; indeed, it assiduously vests a regular commercial deal with political overtones whenever this is advantageous.

Looking to the next decade, Soviet trade will expand, perhaps four to five times its present volume. It could go higher. But there are constraints: (a) China and the European satellites have a heavy claim on its trade potential; (b) its range of exportable commodities is limited due to uneven industrial development; (c) its own raw material requirements will limit exportable surpluses and its capital needs will restrict the export of machinery; (d) the free world nations are formidable competitors; (e) the ruble is inconvertible and Soviet trade connections and traditions cannot match those of the West.

Nevertheless, as a growing market and source of supply the Soviets can extend their influence through trade. The extent to which they do so will, in good measure, be determined by the policies and trade of the major nations of the West. The developing countries, heavily dependent on exports, need markets; should the West restrict these markets, trade will flow elsewhere.

V. CONCLUDING COMMENTS

Based on CEIR's production growth projections, total trade from 1957 to 1970 seems likely to increase roughly 50 percent, or about an average of 4 percent per annum. This is almost the percentage increase in the aggregate of trade from 1928 to 1956, a period disrupted by worldwide depression and worldwide war.

Growth in the imports of foodstuffs into the industrial nations will rise more slowly, roughly 35 percent.

Metal and ore imports should do better, ranging within a 125- to 150-percent increase.

Petroleum imports are expected to increase somewhat more than the ore and metal growth.

These are orders of magnitude. Again there is no certainty, no more than there is about the growth projections. Policy and economic forces are always conjointly involved, each influencing both growth and trade. And obviously production growth and trade are not independent variables; each conditions the other. Policies and circumstances favorable to growth will promote trade; otherwise trade will grow more slowly. At the same time, policies restrictive to trade will tend to hold back economic growth.

As U.S. production grows over the next decade, this country will increase its imports, probably somewhat in relation to its rising national income. But trade policy is important here; increased restric-

tions would both limit imports and curb economic expansion by adding to production costs, in both ways hurting export prospects. Restrictions invite retaliation, to the general detriment of trade and expansion.

Greatly expanded foreign trade is essential to U.S. national interest, in terms of international political influence, internal economic growth, and long-run national security. Increasingly, domestic policies and practices must take cognizance of their foreign implications. Growing economic strength in Western Europe makes this an ordinary competitive necessity; Soviet growth makes this a national security requirement.

A program of economic development aid to the underdeveloped nations must release them from their predominant dependence on exports of raw materials as a means of financing their economic growth. They should be encouraged to seek improved standards of living through industrial development as one sector of a balanced program of economic development. Industrial development and the accompanying increase in standards of living will mean better markets for American exports besides enabling those countries to strengthen their position in the free world defense against Communist penetration. Industrial development may make these countries competitors of the United States at least in their own home markets, but such an eventuality poses no problem for the U.S. economy as long as the policies of economic growth and freer international trade recommended in this report are carried out.

CHAPTER 4

TRADE, AID, AND THE BALANCE OF PAYMENTS

I. INTRODUCTION: THE PROBLEM

Recently the president of the Federal Reserve Bank of New York said:

We can no longer conduct our affairs, monetary or otherwise, on the comfortable assumption that the international balance of payments is something that foreigners must worry about, not we Americans.

While abroad recently the Chairman of the Board of Governors of the Federal Reserve System noted that—

One distressing experience was to find among intelligent and perceptive men in those countries a growing distrust over the future of the American dollar.

Commenting on the recent move toward increased currency convertibility in Western Europe a Chase Manhattan Bank publication asked:

Does the growing strength of European currencies reflect a corresponding weakness of the dollar?

These comments reflect varying degrees of concern over the international financial position of the United States.

On the other hand, we must be cautious in extrapolating what might prove to be a temporary situation, generated by the recession, into the distant future. There are already some signs of improvement. Walter Lederer, Chief of the Balance of Payments Division of the Department of Commerce, said recently:

Several developments can be anticipated at this time * * * which should improve the balance of payments. * * * The balance-of-payments problem is not likely to disappear as a result of these economic developments already under way, or actions already taken. Its magnitude, however, is less than the current rate of net payments would suggest, and well within our capacity to adjust. * * * The narrowing of the balance-of-payments gap will depend mostly upon the strengthening of our competitive position, however, both in foreign and in domestic markets.²⁵

Some of the basic facts of the situation are the following:

1. Over the past 9 years the United States has had an average balance-of-payments deficit of \$1.5 billion per year. This \$13.5 billion deficit has added materially to the gold and dollar reserves of foreign countries, mainly West European.

2. In 1958 alone, the deficit amounted to \$3.4 billion, \$2.3 billion of which was taken in gold and \$1.1 billion added to foreign held dollar balances. The large deficit continued to build up during the first half of 1959.

3. Over the past 9½ years U.S. gold stock has declined some \$4.2 billion; "free gold," not required as legal reserve, is present-

²⁵ Survey of Current Business, June 1959.

ly almost \$9 billion. However, it should be borne in mind that the gold reserves of the rest of the world were depleted during the war and that the growth of world economic activity could demand additional gold if prewar relationships are to be reestablished.

4. U.S. short-term liabilities to foreigners are now \$16.6 billion, \$8.6 billion of which are the exchange balances owned by foreign central banks or other official institutions.

5. Exclusive of the United States, the free world monetary gold supply is approximately \$18 billion.

These facts show a substantial strengthening of the West European international financial position (the reserves elsewhere are, with few exceptions, very low) over the past decade. This has been an object of U.S. foreign policy; the U.S. balance-of-payments deficit has financed it. This is not to say we set out to achieve precisely the deficit we have had, or to build up foreign gold and dollar balances precisely to present levels. A surplus or a deficit is the outcome of all the claims against us, and our claims against foreigners. Most items in the balance of payments, except foreign aid loans and grants, are not subject to U.S. Government control; and most U.S. Government financial commitments (for example, economic and military aid) are prompted by considerations unrelated to their balance-of-payments effects.

The latter point goes to the nub of the problem. What effect would the balance-of-payments problem, if it continues, have upon our foreign policy, especially in respect of foreign aid? Are we approaching the point where the balance of payments might exert restraint on our foreign commitments? If our trading position, our foreign military and aid commitments, and other transactions that cost dollars cause continued deficits, would foreigners be willing to accumulate more dollars? Or would they lack confidence in the dollar and insist on U.S. gold exports?

There is one most important point that must be made here. Our balance-of-payments position is in two distinct compartments. We have military commitments in Western Europe that cost money. Our balance of payments with that area shows an excess of payments over receipts. The soundness of that position depends upon Europe's willingness to hold dollars. This in turn depends upon our ability to maintain a stable price level, or at least a price level which is not rising more rapidly than world prices in general. With confidence in the stability of the dollar, that is, willingness to hold dollars, there should be no problem. In effect, it would amount to willingness to lend to the United States. If there is a lack of confidence for any reason, then an adverse payments position would lead to an outflow of gold, which, of course, cannot continue indefinitely and must ultimately lead to corrective action, preferably by stimulating exports.

As regards the underdeveloped areas, the problem is quite different. They need capital imports badly. The provision of aid in the form of free dollars might, if U.S. goods are overpriced and there is lack of confidence in the dollar, lead to their buying some of their capital goods with dollars in Western Europe and hence to an increase in our gold outflow to Europe. If both conditions hold, therefore—i.e., U.S. capital goods overpriced and lack of confidence in the stability of the U.S. dollar—we might be forced to tie American aid to purchases in

the United States. If this is done, the effect of such foreign aid on our balance of payments will not be injurious, since, while we provide the dollars, they will tend to be offset by the increase in our exports. As already noted, such a policy would have deleterious side effects and should be avoided if possible. Basically, this country needs to look to its international competitive position—its costs, prices, quality, and innovative capacity—to avoid the need for the expedient of tied loans.

In other words, if there is a reluctance to accumulate more dollars, or many more dollars, then the U.S. gold stock tends to bear the deficit, or some part of it. Western European holders of dollars have several choices: (1) They could add to their dollar holdings; (2) they could stabilize their dollar holdings and take gold; and (3) they could even reduce their dollar holdings by purchase of U.S. gold. These are their decisions to make, not ours. Their decisions on this matter partly determine the scope and character of U.S. foreign economic policy and commitments. A historical precedent may not be out of order. Late in 1931 the French Government sought certain political understandings from the United States and a favorable interest rate on its sizable balances in New York as conditions for maintaining these balances rather than withdrawing them in gold.

Such problems would not arise in a "dollar shortage" environment. But if persistent U.S. balance-of-payments deficits produce something of a "dollar glut," U.S. policy would face constraints. Tying U.S. foreign development aid to the purchase of U.S. goods may permit us to continue foreign aid without aggravating a balance-of-payments problem. This is no solution, however, to the problem of maintaining confidence in the dollar. The solution is to maintain an internationally competitive position for U.S. goods. This would contribute to the strengthening of the free world and enable the United States to undertake bold, vigorous developmental programs in underdeveloped countries.

II. THE BALANCE OF PAYMENTS AND FOREIGN AID

Looking ahead 10 years the United States probably could not stand the balance-of-payments deficit it has had over the last 10 years without exposing itself to uncomfortable hazards. Although the balance of international payments reflects the financial aspects of all international transactions, a persistent deficit is likely to draw attention particularly to that part of the dollar claims against us represented by U.S. Government commitments to Western Europe. As policy matters, these are subject to specific control; i.e., they could be cut back or withdrawn entirely. Some general comments on foreign aid and the balance of payments seem in order.

The extent to which U.S. Government overseas expenditures affect the balance of payments is not always indicated by their size. For example, U.S. aid expenditures in large measure lead directly to additional U.S. exports; thus not every dollar of aid strains the balance of payments by an equivalent amount. Total aid under the Mutual Security Act through 1958 was over \$45 billion. Of this over \$26 billion was spent directly on U.S. commodities for export and over \$8 billion was spent abroad for foreign commodities. The latter had an adverse balance effect at the time; the \$26 billion expenditure did not di-

rectly and perhaps not indirectly. The remaining \$11 billion was spent for ocean freight, technical assistance, administrative expenses, and related costs. Some of these noncommodity expenditures obviously were made abroad, others in the United States. On balance, the International Cooperation Administration estimates that 76 percent of all mutual security and predecessor program commodity expenditures were made directly in the United States;²⁶ the remaining 24 percent added directly or immediately to the balance-of-payments deficit.

The effects of foreign aid on the balance of payments can vary considerably. Under some circumstances foreign aid will not have an adverse balance effect; indeed, it could improve the balance under special circumstances. Or only part of the aid might accumulate in foreign balances, as the above data suggest. Conceivably, the full amount of any aid program could have adverse balance effects. Some of the possible effects will be briefly reviewed.

An underdeveloped country in balance-of-payments difficulties will readily spend any increment to its reserves provided through aid. If it spends this aid to purchase U.S. goods, then U.S. exports match the aid and no deficit effect arises. Being short of reserves to begin with, the goods thus bought are not substitutes for normal imports. If these imports are capital goods, the stimulus to the economy might induce it over a period to buy even more U.S. goods than it would have bought had there been no aid at all. However, if the aid funds can be spent in a third country (at present about half is so spent) such aid does not automatically lead to a rise in U.S. exports. The third country might add these funds to its dollar balances or spend them to obtain U.S. gold.

A complicating factor in the assessment of the balance-of-payments consequences of an aid program lies in the difficulty of knowing what the recipient country might have done in the absence of the aid. Suppose military aid is given to a country with adequate dollar reserves; this aid then relieves the recipient country of the need to use its own dollar resources to buy the equivalent amount of military equipment from the United States if it planned to spend that much in military items anyway. Even though all the aid funds are spent in the United States, the program would worsen the balance of payments by the full amount. Of course, the recipient might then import more non-military goods from the United States, using its own dollars. No deficit might arise at all or only in part. There are other possibilities as well.

The willingness of foreign countries to accumulate more dollar balances depends on many things: (a) the confidence of foreigners in the dollar; (b) their need for additional working and emergency balances of dollars; (c) the conventional attitudes of foreign monetary authorities toward the proportions of gold and exchange in their reserves; and (d) the country distribution of the U.S. deficits.

Confidence in the dollar depends largely on the internal stability and strength of the U.S. economy. While prices (gross national product price deflators) have risen 12 percent here since 1953, they have risen 17 percent in Western Europe.²⁷ The dollar is not in a spongy

²⁶ "The Mutual Security Program, Fiscal Year 1960, a Summary Presentation."

²⁷ Organization for European Economic Cooperation, "Policies for Sound Economic Growth," p. 15.

state; we should not overlook the fact that despite our gold outflow Europeans still added over \$1 billion to their U.S. balances last year. The large drain of gold in 1958 was partly due to the fact that much of the deficit accrued to countries that traditionally hold their reserves largely in gold. Working and emergency balances of dollars can be expected to grow—if some deficit continues—with the worldwide expansion of trade. With the prospective growth in world trade, a \$400 to \$500 million annual addition to reserves is likely in the next few years, with larger increments as the years go on.

The reserves created by the U.S. balance-of-payments deficit have strengthened the economic and financial position of the West, particularly the North Atlantic community. With this strengthening they can take over more of the job of strengthening the other portions of the free world. This they are doing, and they can do more.

As noted above, the effect of foreign aid on the U.S. balance of payments is complex. Most foreign aid in the past has stimulated U.S. exports, thus offsetting most of the immediate adverse effects. The larger part of the current foreign aid is military (including expenditures of service personnel), most of which is spent in countries now enjoying sizable dollar balances. The additional dollars might increase their purchases of U.S. goods, or they might be added in whole or in part to their present dollar balances, or they might be converted in whole or in part into U.S. gold. The decisions of foreign governments are crucial; and the decisions are theirs to make. Herein lie the potential financial constraints on U.S. foreign policy decisions in the future.

Foreign aid is only one element in the balance of payments. The massive component is merchandise trade. But trade, aid, private capital movements, and other components are interdependent elements in the balance of international payments. Foreign aid affects exports; the export-import position in turn influences our capacity to undertake foreign commitments by way of the balance of payments. Future export-import trade trends are therefore vital. Some of the issues and possible developments that might affect this trade will now be reviewed.

III. TRADE AND OTHER COMPONENTS IN THE BALANCE OF PAYMENTS: SOME ISSUES

It is difficult to form a judgment on the future of the balance of payments of the United States or on the decisions of our principal trading and financial partners with respect to their gold and dollar balances. The balance of payments is compounded of two large numbers—total receipts and total disbursements. A small error in the estimate of either magnitude can overturn any prediction of the balance between the two. However, there are issues now forming and problems arising which will affect the future trends in receipts and disbursements. Some of these need review for the consideration of those responsible for foreign policy decisions.

Briefly, there are possible developments which could create long-run balance-of-payments pressure on the United States; other developments point in the other direction. The respective weights of these opposing developments are partly matters of policy, domestic and foreign. These policy matters will be reviewed in the course of the subsequent discussion.

A. BALANCE-OF-PAYMENTS DISBURSEMENTS

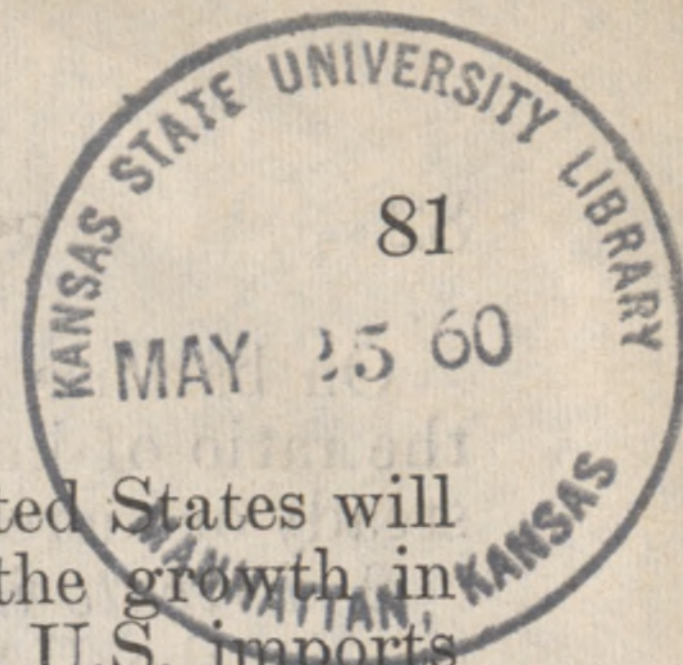
1. *Imports.*—It is possible that imports into the United States will be under a special stimulus beyond that induced by the growth in gross national product. Since 1953 the ratio between U.S. imports and gross national product has been at or slightly below 3 percent. Henry Aubrey in "United States Imports and World Trade" projects a rise in the ratio to 3.2 or 3.5 percent when U.S. real output is twice the 1950 level. This would roughly approximate the CEIR gross national product projection for 1970. Sir Donald MacDougall in "The World Dollar Problem" gives 3.2 percent as his high estimate; his low estimate is 2.7 percent.

The previous chapter noted the growing reliance of the United States on an increasing number of ores and metals and on petroleum imports. At the turn of the century the United States produced most of its basic commodities and exported some in addition. At present the United States is a net importer of raw materials, buying nearly 40 percent of the free world's supply. As already noted, over the next decade there will be some substantial increases in U.S. imports of iron ore, bauxite, manganese, petroleum, and a wide range of other commodities. This category as a whole accounted for 55 percent of U.S. imports in 1957. This category more likely than not will tend to increase in relation to growth in gross national product.

It is far less clear whether foreign imports of manufactured goods will keep step with, fall behind, or exceed the rate of U.S. growth. Evidence is accumulating that foreign manufacturers are becoming increasingly competitive in the U.S. and foreign markets. This could grow; in many respects the United States is a high-cost economy, especially where labor is a high proportion of the cost. This fact bears directly on the competitive position of U.S. industry in its own market and in markets overseas.

Costs are boosted by quotas and tariffs; protection to one group is a cost to others. Government price supports add to the input costs of some industries. Many industries, as a matter of inertia or common interest, buy high-priced U.S. equipment rather than low-cost imports and pass the cost along in price. High corporate income taxes probably get imbedded in the price of much industrial output; moreover, such taxes reduce incentives to cut costs and in some cases add to overhead cost. Wage rates in many lines are high in relation to productivity comparisons; productivity differences narrow or vanish as foreign producers modernize and take the advantages of scale.

If these and other cost-boosting influences gain strength, and/or price increases are induced by monetary and fiscal policies in excess of price changes abroad, competition from abroad would tend to get keener. Here are several facets of domestic policy and business and labor practices which bear on the U.S. balance-of-payments position. The future volume of industrial imports can be expected to grow as national income rises. Price increases in relation to foreign prices would tend to stimulate such imports. Efforts to mitigate these competitive pressures by import restrictions would curb imports, but at some cost to U.S. exports, the rate of U.S. internal growth, and foreign policy purposes. Such restrictions are not likely to ease a balance-of-payments deficit.



On balance and in the absence of a surge of restrictive measures, the ratio of imports to gross national product is more likely to hold steady or increase than to decrease.

2. *Private investment.*—In recent years the sale of foreign securities in the U.S. market has grown rapidly. In 1956 portfolio investment was \$457 million; in 1958, \$956 million. In commenting on the 1958 spurt in offerings of dollar bonds, the Federal Reserve System noted that—

A major factor in the growth of issues by foreign governments has been increased investor confidence in the ability of borrowing countries to meet the future dollar obligations represented by the bonds.

Since there is little to suggest any lessening of this ability in the developed economies, the flow of net issues might rise. Moreover, the forthcoming increase in the capital of the International Bank for Reconstruction and Development will assure its continued role in assisting the outflow of American funds.

Over the decade ahead, direct investment will probably increase. In the postwar period, U.S. direct investment overseas has been led by the oil industry. The Chase Manhattan Bank in its "The Future Growth of the World Petroleum Industry" estimates the 1957-67 worldwide petroleum industry capital investments at \$140 billion to meet projected demand. This is twice the level of capital expenditure in the previous decade. More important, capital investment for foreign oil development will rise even faster, to almost 2½ times the previous rate. A boom is also ahead in iron ore; imports will grow, perhaps to two or three times their present levels by 1970. With American steel companies already established abroad, one may reasonably assume a substantial expansion of U.S. overseas investment in iron ore mining. The exhaustion of certain U.S. natural resources will increasingly drive American firms overseas for basic materials.

Structural changes in Western Europe also suggest faster growth in U.S. direct investment. Influenced by the prospect of a market of more than 160 million and tariff discrimination, more and more American firms are considering penetrating the markets of the members of the European Economic Community (Common Market) through investment rather than through exports. It is not unlikely that this investment will have an adverse effect on the U.S. balance of payments, partly because it substitutes for a future growth in U.S. exports which otherwise would have been sold, and partly because the U.S. export content of the investment in the Common Market is likely to be lower than direct investment elsewhere. In part, existing plants are being bought rather than being constructed; in part, the proximity to technologically advanced capital goods industries in Western Europe may induce American business to buy more of the required equipment in Europe rather than in the United States. In the first few years, however, considerable exports of U.S. capital goods are likely to follow the investment in the Common Market. This would reduce the adverse effect of the investment on the balance of payments. The possible impact of the Common Market on U.S. exports will be noted below.

3. *Summary on payments.*—U.S. disbursements for imports, for private capital investments, for tourist expenditures and capital remittances, and for foreign aid promise to provide an increasing flow

of dollars to foreign accounts. Whether this flow increases or diminishes the past rate of deficit in the U.S. balance of payments depends upon the flow of receipts, mainly from exports.

B. BALANCE-OF-PAYMENTS RECEIPTS

1. *Exports.*—As the largest component, U.S. export trends and developments are crucial in a consideration of the balance of payments. Opinion as well as expert judgment vary on export trends. Some fear is expressed that the United States is “pricing itself out of the market”; against this is the hard fact that the import of U.S. goods in all or most countries is restricted by high tariffs, quotas, or exchange controls. The evidence on cost or price is not conclusive, but the fact remains that U.S. exports are encountering increased competition as the industrial nations of Western Europe increase their capacity and productivity.

The Economic Commission for Europe notes that—

During the 1950's * * * Western Europe reversed its trading position vis-a-vis the United States from that of a net importer of manufactures to that of a net exporter. * * * This was accompanied by an appreciable substitution of Western European for United States exports of manufactures in third markets. From 1952 to 1957 Western Europe's share of the combined export of manufactures (at 1950 prices) of Western Europe and the United States to primary exporting countries rose from 64 to 68 percent.²⁸

The Commission apparently expects these trends to continue for it writes that—

Since the large-scale devaluation of Western European currencies in 1949, a process of substitution of Western Europe exports for those of the United States has been going on and there are as yet no definite signs that it is coming to an end. Thus, present long-term trends may well be interpreted as pointing toward a further reduction of the difference in strength between the dollar and the Western European currencies.

The Department of Commerce reports that—

data indicate that prices of steel, machinery, and vehicles appear to have risen since 1953 faster in the United States than in the United Kingdom and even more so than those in Germany. * * * For many other commodities prices are determined by the world market, and exports from the United States are priced about the same as those from other countries.

The Department further notes that—

The difference in the price movements for machinery and vehicles and iron and steel were present at least since 1954; yet exports have risen sharply until recently. These differences continued but did not widen in 1958, but exports have fallen off.²⁹

The Assistant Secretary of Commerce, Mr. Henry Kearns, recently noted that—

The average rise of all prices since 1953 in the United States appears to have been less than in the United Kingdom and France, and about the same as in Western Germany and Italy. And U.S. export prices for manufactures, while rising appreciably further since 1953 than those of Germany and Italy, have not risen out of line with those of the United Kingdom and France. This “pricing ourselves out of the market” has been attributed by some to the wage spiral. But on the whole, industrial wage rates have not risen more rapidly in the United States during the past several years than in the principal European countries, and the average labor cost per unit of industrial output appears to

²⁸ Economic Survey of Europe in 1958, ch. 3.

²⁹ Survey of Current Business, December 1958, p. 7.

have risen by relatively the same proportion in some industrial European countries as it has in the United States.³⁰

While the evidence does not clearly indicate that we have priced ourselves out of some world markets, data on the U.S. share of those markets suggest increased competition. The U.S. share of world trade in manufactures, after running 25.2 percent and 25.4 percent in 1956 and 1957, dropped to 23.2 percent in 1958. The total value of manufactured goods exports by Britain, Germany, France, Belgium, and Japan rose between 1957 and 1958 while the total value of those exports by the United States declined.³¹

It may simply be that the 1958 recession revealed for the first time a competitive weakness of the United States. Our prices have proved less responsive to dropping off of demand in recession than those of other countries, with adverse effects on our relative price level. The Federal Reserve Bank of New York writes that—

It is nevertheless true that in recent years the prices of manufactured products appear to have risen more sharply in the United States than in such competing countries as the United Kingdom and Germany. The fact that these differences were not noted as deterrents to U.S. exports until recently, however, suggests that there may have been offsetting factors which had obscured these differentials for some time. By 1958 many of the factors which had in effect shielded domestic products from the full effects of international price competition were turning around.³²

And here the bank lists greater availability, shorter delivery periods, more attractive credit terms, improved quality or design of products, and better servicing facilities on the part of foreign competitors.

One method by which the recession affected U.S. exports is described by the Department of Commerce in the following manner:

When foreign demand, particularly for investment goods, increased faster than foreign capacity to meet it, as was the case between 1953 and 1957, delivery periods abroad lengthened, and a rising part of this demand was directed to this country where delivery periods were shorter even if prices were somewhat higher. As the rise abroad slowed down during the latter part of 1957 and in 1958, while foreign capacity to produce such goods expanded, the order backlog of foreign producers declined and their delivery periods shortened with the result that price relationships became more important in the distribution of the international demand between the various producers and their countries.³³

Somewhat the same phenomenon may have occurred in respect to U.S. imports, as we have apparently become marginal suppliers of many products we import. Walter Lederer contends that—

The experience during recent years indicates * * * that the balance in our international transactions, is influenced increasingly by business conditions abroad and to a less extent perhaps by business fluctuations within the United States. For many commodities the United States has become the marginal supplier both in export and in domestic markets.³⁴

If this view is right, and the experience of 1958 certainly is consistent with it, then the prospects for U.S. exports and for the balance of payments as a whole depend significantly on the vigor of foreign demand and production. It is not so important, for example, to know that Western Europe will continue to grow, as it surely will, as it is

³⁰ Address before the Cleveland World Trade Conference, Apr. 2, 1959.

³¹ London Economist, Apr. 4, 1959, p. 65.

³² Monthly Review, March 1959, p. 45.

³³ Survey of Current Business, December 1958, p. 7.

³⁴ Lederer, Walter, "International Liquidity and the U.S. Balance of Payments," address before the 45th National Foreign Trade Convention, Nov. 19, 1959.

to know the balance between demand and supply in that growth. This is so much a function of policy on the part of foreign governments that little can be said.

The formation of the European Economic Community clouds the future of U.S. merchandise exports. In 1957, U.S. nonmilitary exports to all Western Europe reached a new—and temporary—high of \$6 billion. Of these, slightly more than half went to nations belonging to the EEC. In a careful analysis of the trade data for 1955, Howard Piquet, of the Legislative Reference Service of the Library of Congress, concludes that 32 percent of U.S. exports to the EEC countries will undoubtedly be affected and that “these are in the lines in which American industry and European industry are most directly competitive.” Another 27 percent, mostly agricultural products, can also be affected, though the direction of the effect depends on EEC action in the protection of domestic agriculture. The remaining 40 percent Piquet rules safe.³⁵

Walter H. Diamond, Director of the Foreign Economic Department of McGraw-Hill International Corp., concludes that about 35 percent of U.S. exports to the EEC will be adversely affected. Some measure of the adverse effect is suggested by a McGraw-Hill survey of expectations of U.S. firms. The small U.S. exporter expects eventually to lose 80 percent of his present business, the medium-sized exporter 60 percent, and the large corporate exporter 30 percent.³⁶ Because U.S. exports to EEC countries have been one-eighth or more of total U.S. exports since 1953, such slashes could spell trouble, especially when it is recalled that only slight shifts in the components of the balance of payments are necessary to cause major changes in the balance between receipts and disbursements.

The great unknown of EEC is what effect, if any, the additional growth of EEC real income attributable to increased efficiency achieved through expanded internal trade will have on the demand for U.S. exports. A further uncertainty concerns the extent to which American firms investing in the EEC will rely on the United States for capital equipment. It is not impossible that, in the buildup period of the next 3 to 4 years, total U.S. exports to Western Europe could rise because of the need for capital equipment in American-owned plants overseas, though this presumably would only mean that the adverse effect of the investment on the balance of payments was reduced. Still another uncertainty concerns the return of profits on those investments, which, of course, adds to the U.S. receipts. But unless the rise in investment is very substantial, the returned profits are not likely to make up for lost export receipts. If the investments are really profitable, significant amounts of the profits will be reinvested. And, while the decision of a firm to invest abroad may protect that firm's profits against the loss of export profits, it need not protect the balance of payments since, to induce such investment, it is necessary only that the profit margin on overseas production exceed the profit margin on, and not the total value of, exports.

The possible threat to U.S. merchandise exports extends to the whole of Western Europe and the other industrial countries of the world. The Federal Reserve Bank of New York notes that foreign

³⁵ Commercial and Financial Chronicle, Jan. 15, 1959, p. 27.

³⁶ Commercial and Financial Chronicle, Jan. 15, 1959, p. 6.

competition has certainly grown more intense, both at home and abroad.

The advantage of large capacity and advanced techniques, held by the United States because of the war destruction in other industrial countries, has been largely whittled away, and foreign producers now are frequently able to offer the same quick delivery and high quality as U.S. firms.³⁷

According to the Department of Commerce:

The U.S. share of the total European trade in manufactured goods * * * has been gradually contracted by European competition. The preponderant factor has been the growing capacity of Western European countries to supply goods for themselves and for each other.³⁸

In addition, European needs for certain semifinished products have declined as they have become equipped to process raw materials.

C. COUNTERARGUMENTS

The rather distressing and somber implications of the arguments set forth above are subject to challenge on several counts:

1. As the Federal Reserve Bank of New York has noted:

* * * the fact that many countries still apply discriminatory restrictions to imports from the dollar area suggest that there are many products in which the United States retains a considerable competitive advantage.³⁹

Unfortunately, it is not possible to tell how sizable the latent demand implied by such controls may be and to what extent efficient local suppliers have been built behind the protection of import controls in these recent years of economic progress abroad.

2. In the past the American competitive advantage in foreign markets rested in part on the early introduction of new products. As the Department of Commerce explains:

The advantages in the sales of specific products may be lost as foreign countries resume and expand their production but the relative position of the United States will depend upon the speed of that process and the development of new products or the improvement of those previously sold. This is the usual process of competition in which success depends upon the relation between the development of innovations and the loss of markets to those who take up the production of goods previously developed.⁴⁰

A number of economists have built a theory of a dollar shortage on the innovative superiority of the United States.

It is quite obvious that the economic changes in Western Europe and elsewhere serve to enhance the innovative capacity of our industrial competitors. At the same time, there is no evidence that we have lost our innovative propensities, though admittedly there is no direct evidence that we have gained in this respect. Innovation is a characteristic of U.S. industry but, in general, it is not focused on the export business. Exports are a sideline for most American manufacturers. Any export advantage from innovation is usually a side effect of their domestic business. In the normal course of business, however, innovations pour forth; as long as they do, U.S. exports will increase.

3. Another favorable factor is that U.S. exports consist in part of products for which world demand may rise strongly in the future.

³⁷ Monthly Review, February 1959, p. 21.

³⁸ Foreign Commerce Weekly, Nov. 24, 1958, p. 3.

³⁹ Monthly Review, February 1959, pp. 21, 22.

⁴⁰ Survey of Current Business, December 1958, p. 7.

If all goes well in the international economy, the imports of the non-industrialized countries will rise faster than world trade, and their imports have in the past increasingly consisted of capital goods. The importance of exporting products for which the world demand is rising strongly is underlined by the fact that, between 1913 and 1929 when the United States enjoyed a substantial export boom, perhaps four-fifths of its exports, for which data are available, consisted of products in which world trade increased by more than 75 percent. In recent years, about 30 percent of U.S. merchandise exports have consisted of capital goods.

4. The adverse effects of the formation of the European Economic Community on U.S. exports which were suggested earlier could be offset if the EEC induces a surge in the members' economic development.⁴¹ To the extent that the widening of the European market permits countries to enjoy greater economies through large-scale production and to the extent that increased competition among firms improves their productivity, the real income of the members of the EEC should rise further than otherwise possible. This would, in turn, improve the EEC as a market for U.S. exports. While it may not do so for some of the products which we currently export to the area because of discrimination, the fact remains that with adjustments in the structure of American exports, we could take advantage of any such growth, should it occur.

5. With worldwide economic growth, U.S. industrial exports will rise, and by a substantial amount, despite the growing competition from the industrial nations of the West. In one area, neither they nor any other major producer, save Canada, can effectively compete. This is in agricultural production. World demand for food will inevitably increase, with population growth prospects what they are. In the crowded countries, a substantial increase in food might come at a high cost. Here, with large space, an efficient agricultural technology, and a large capital investment in agriculture, the United States could become increasingly an agricultural exporting nation. The industrial and agricultural combination in this country gives it an advantage not matched elsewhere.

IV. SOME CONCLUDING POINTS

1. On balance, the influences which are likely to stimulate a long-term growth in imports seem, at this juncture, to be somewhat stronger than those that will stimulate U.S. exports. It must be said at once: this is a tentative judgment. The variables underlying trade trends are numerous and most of the important ones are unpredictable. But some elements seem to be shaping up with a considerable degree of certainty.

The U.S. economy will become increasingly dependent on primary commodity imports. A rising national income will encourage imports of a wide range of finished commodities. U.S. foreign investments seem more likely to increase than to level off or decline. U.S. exports will rise in response to growth and increased incomes abroad. The

⁴¹ "Even more than the United States, the European Community is expanding at a phenomenal rate. In the past 10 years, the industrial production of our member nations increased 97 percent. Within the next 15 years we expect that this production will grow another 100 percent." Bulletin from the European Community, May 1959.

evidence is sufficiently clear, however, that these exports will encounter stiffer competition as industrialization gains ground elsewhere. Traditional trade patterns are being reestablished, at some cost to U.S. exports.

On balance, the margin of U.S. exports over imports of the past decade is more likely to narrow than widen in the decade ahead. This is a tentative judgment. In CEIR's view, developments since the early 1950's give it somewhat more support than the contrary position.

Assuming the margin is more likely to narrow than to widen, the United States seems faced with a continuing balance-of-payments deficit, given its foreign policy commitments. The deficit may average somewhat less in the future than in the past, but this is by no means certain. As noted earlier, if world trade expands at an average rate of about 4 percent, foreign working balances would probably grow, absorbing some of the dollars generated by the adverse balance. Gold reserves are likely to grow; the International Monetary Fund staff estimates growth from current production at \$700 million per year. This would tend to ease pressure on the U.S. gold stock.

The prospective increase in U.S. dollar obligations might be no more than required by a normal growth in the need for exchange balances. But it could increase by considerably more.

In either case, the United States faces a mounting volume of international financial obligations, payable when and if wanted in gold.

2. The presence of sizable foreign-owned balances raises other problems. Gold flows can be influenced by Federal Reserve policy. The rise in interest rates in 1958 probably slowed the gold outflow. Probably Federal Reserve rediscount policy may need to be related increasingly to the control of gold movements. Interest rate policy for this purpose could be inconsistent with the requirements of internal economic growth. Conversely, an interest rate policy to promote growth could expose the United States to heavy loss of gold. This raises a difficult problem of choice.

The growing position as short-term debtor poses other problems for the United States. Fiscal policy should now be closely related to the U.S. international financial position. Inflation could sap foreign confidence in the dollar. Apart from fiscal policy, other practices and policies affecting costs and prices have a bearing on foreign confidence in the dollar. Unions and business firms as a rule conduct themselves as though the United States were a closed economy. Price increases both erode confidence in the dollar and raise difficulties in the balance of payments by restraining exports and encouraging imports. Restraints on exports, in turn, inhibit internal growth.

It is important to realize that the key question is confidence in the U.S. dollar. This is a function of our success in fighting the cold war and of our success in maintaining financially sound domestic policies. If there is sufficient confidence in the dollar that a balance-of-payments deficit with Western Europe results merely in the accumulation of dollar balances, this is no occasion for alarm. In this context, economic assistance to underdeveloped countries would add somewhat

to those balances and to an increase in U.S. capital goods exports. In this environment we could continue to play the role of good banker to the underdeveloped countries, supported also by similar efforts on the part of Western Europe. We must be careful not to develop points of view based on hasty reactions to this complex situation. Most of all, we must not allow old shibboleths to force us into the wrong policy conclusions from the point of view of the cold war. The balance-of-payments deficit is not the basic problem. The basic problem is to assure that public policy and business-labor practices maintain this country in a vigorous competitive position in the world economy.

3. The general trends outlined in the foregoing are likely to put other pressures on U.S. foreign policy. Protectionist sentiment mounts with the competitive pressures from abroad. The lead, zinc, and petroleum quotas are cases in point. The Senate Interior Committee is considering legislation to impose quotas on fluorspar, and other industry groups are lining up for similar protection. The U.S. Chamber of Commerce has to some extent backed away from its liberal trade position of recent years.

This trend has far-reaching implications for U.S. foreign policy.

(a) Such restrictions have a damaging effect on United States economic and political relations with individual countries in the free world, and thereby weaken the ability of the community of free nations to achieve a unity of purpose and action.

(b) Restrictions on imports are likely to cause exporting countries to turn to the Communist bloc and weaken the security position of the United States and the free world.

(c) Import restrictions add to the costs of doing business and limit the capacity of foreign countries to buy U.S. exports. On both counts U.S. growth prospects would be adversely affected, to the detriment of the U.S. international position.

(d) By maintaining a liberal import policy, the hand of the United States is strengthened in working toward liberalization of import policies abroad. This effort is necessary and promises relief from balance-of-payments pressures.

(e) National interest requires a general expansion in multilateral trade. Trade, as well as aid, will play a major part in the growth of the underdeveloped countries. These countries in turn will become increasingly important to the growth of the U.S. economy. Trade is essential to the continued expansion of the Western European economy. As stressed before, Western Europe's role in promoting economic development should grow as part of a free world economic strategy.

4. The projected expansion of the Soviet economy, described in chapter I, poses a danger for the United States and the free world generally. Soviet intentions are known. Their efforts to expand political and economic influence will raise innumerable problems of both foreign and domestic policy. A sound rate of growth, freer international trade, and effective and soundly based programs of economic assistance to the less-developed areas will equip the United States to meet that danger successfully.

Thus, the decade ahead will present many problems in the international area. But this point needs driving home: the free world presently holds an overwhelming economic advantage in the unfolding international economic contest with the Communist countries. This advantage can be held and in fact strengthened if free world countries provide the incentives and the means for rapid growth and for an expansion of worldwide markets to forge closer economic bonds among themselves. Above all, the free world must recognize the need to put its full weight cooperatively behind long-range growth programs of the underdeveloped countries to give them real hope, the only final answer to the Soviet siren song which seeks to lure them into the Soviet orbit and to enslave their peoples under programs of "growth with little consumption."

APPENDIX

STUDY III. WORLDWIDE AND DOMESTIC ECONOMIC PROBLEMS AND THEIR IMPACT ON THE FOREIGN POLICY OF THE UNITED STATES

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Submission date: July 20, 1959

Purpose.—This study will explore the extent to which economic relations affect foreign policies and foreign policies affect economic relations. While it will include the relationship of such economic questions as trade, fiscal policy, and monetary policy to foreign policy, the major emphasis will be on the problems affecting the major industrial nations.

OUTLINE OF STUDY III

- I. Findings of the study.
- II. Conclusions and recommendations.
- III. Main body of the report.
 - A. Introduction: Statement of viewpoint and focus of the research undertaken. The research will concentrate on those major foreign and domestic economic developments and problems likely to generate tensions and strains requiring foreign policy decisions in the future.
 - B. Identification of those economic developments and problems, both domestic and foreign, which at present (and in recent years) have raised important foreign policy issues. Summarize and analyze research materials, and relate the major problems revealed to the present foreign policy position of the United States.
 - C. Define and discuss the present relative (economic) power position of the United States and its relation to U.S. foreign policy, and establish the benchmarks for the analysis of probable future changes (based upon 10-year projections), and their probable impact on U.S. foreign policy. Examine the relative efficiency of Soviet industry as opposed to that of the United States and other countries in the free world.

D. Classify the major problems important to U.S. foreign policy in terms of—

1. Domestic problems and developments bearing on U.S. foreign policy. In particular, examine the prospective long-term growth of U.S. production (gross national product), probable long-term price movements, U.S. foreign investments, U.S. exports (including surplus products) and imports, and the changing balance-of-payments position of the United States. Since much of U.S. foreign policy since World War II has been heavily influenced by the strength here, and weakness abroad, in the balance of payments, present and discuss probable changes in the U.S. balance-of-payments position in the decade ahead.
2. Present and discuss major foreign regional problems and developments. In terms of probable changes and possible tensions calling for U.S. foreign policy decisions, review developments in major geographic regions: Western Europe, South America, Africa, the Soviet Union and China, south Asia, and the Middle East. Attention will be directed mainly to (1) production trends, (2) special commodity problems, (3) foreign trade patterns and changes, (4) price trends, and (5) balance of payments.
3. Analyze the broad subjects listed above in terms of probable tensions they may generate, or a probable easing of strains, as may be indicated. Consider that U.S. balance-of-payments changes now in evidence may lessen certain international strains important in recent years; also that, on the other hand, probable growth in Soviet gross national product and foreign trade are likely to build up other tensions requiring U.S. foreign policy decisions.
4. In the light of the preceding, review and discuss probable shifting in economic power position of the United States vis-a-vis the major regions (listed in 2 above) and the bearing of such shifts on U.S. foreign policy.





