EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON D.C.

September 20, 1949.

To: David D. Lloyd
From: Walter S. Salant
Subject: Your Comments on My Memorandum

1. I have not been in touch with the State Department on the question of loans to the Near and Far East and I realize that the political aspects of this suggestion is extremely important. So far as India is concerned I believe my suggestions would be acceptable to them. I agree with you that Nehru's visit makes it more urgent to get the suggestion to somebody who can make a decision. Unfortunately, I neglected to call the Council's attention to this when I sent them the memo this morning.

2. I haven't recently discussed with the Export-Import Bank the question of whether they are authorized to purchase long-term securities, but I had this general idea in mind when we discussed the investment guaranty legislation with them. I think it was in a meeting that you and I both attended with Walter Sauer and Bernie Roll in the Budget Bureau's office that I asked them whether the words of the statute permitted them to buy bonds. (It authorizes them to "purchase, discount, rediscount, sell, and negotiate ... and to guarantee notes, drafts, checks, bills of exchange, etc., and other evidences of indebtedness") They said they could buy bonds. As to custom approved by Congress, I don't know.

3. The International Bank cannot require that a borrower scale down or defer its claims upon its debtors as a condition precedent to a loan, but, to the extent that the sterling balance problem was to be handled in connection with a loan from the International Bank, the U.S. Executive Director could make it clear that the U.S. would vote for better terms if these claims were scaled down. More important, the sterling balance problem need not be tied to a loan from the International Bank but can be handled in connection with a loan from the Export-Import Bank.

As to disposition of the memo, I have now revised it and sent it to the Council. I am sending you a copy of the final version.

Attachment.
September 29, 1969.

To: The Council
From: Walter S. Salant
Subject: American Policy in the Light of Currency Devaluations

The recent foreign currency devaluations will have effects on the American economy and on the European balance of payments problem which make it desirable to review certain policies and programs to see what changes or additions devaluation calls for. The most important effects of devaluation, from the point of view of policy, are the following:

1. The effect on the domestic economy will be noticeably but not seriously deflationary. The magnitude of the effect cannot be accurately estimated but, to indicate orders of magnitude, devaluation may be thought of as reducing the export surplus by about 1 or 2 billion dollars and as reducing the gross national product by 3 to 4 billion dollars in the first year.\[\] This effect is the net result of two factors:

(a) Intensified price competition of foreign products in the U. S., and foreign markets will increase our imports and cut some of our exports, especially of manufactured products, both to devaluing and non-devaluing countries.

\[\] In this connection I should call attention to the fact that my memorandum of September 16 on the Effects of Devaluations upon the United States Economy anticipated a cut in the pound standing of about 20 percent. The actual cut of 30.5 percent in the pound means a somewhat more deflationary effect than I there indicated.
(b) These effects will be offset by an expansion of other American exports, made possible by increased dollar earnings and dollar savings on trade, by an improvement in the international capital position of the non-dollar area, and by increased gold production. But this offsetting influence, despite being only partial, is likely to make itself felt at a later time than the deflationary effects, because foreign countries are likely to use additional dollars and gold to replenish depleted reserves and, in some cases, repay observed short-term trade debts before they will substantially relax controls against American goods.

While the net deflationary effect over a period of, say, a year will probably not be great in relation to the absolute level of our business activity and gross national product, the first deflationary effect may be significant in relation to the other forces making for business recovery. If these other forces are of only moderate strength on balance, the deflationary effect of the devaluations may be a substantial offset to them.

2. The effects of devaluation on the European balance of payments problem are two-fold. First, it contributes directly toward making Europe self-supporting by reducing the European dollar gap. This will happen even if no other measures are taken. But, in addition, it vastly increases the effectiveness of certain other steps that can and now should be taken to supplement it. How it does this will be indicated in the discussion of these other measures.
The following recommendations for policy action follow logically from these main conclusions. They are intended both to minimize or alleviate the deflationary effects upon the United States and to get the maximum effect out of the devaluations from the point of view of the European balance of payments problem. Rather than branch out into new or changed policies they stay within and, in fact, further this government's existing policies. Such changes as are proposed in certain administrative policies are in the direction of removing present inconsistencies with general policies already laid down.

Some of the actions the United States can take to reduce European dollar difficulties have already been set in motion as a result of the United Kingdom-United States-Canada financial talks and for that reason are not reviewed here. Among these are: (a) the stockpile program, with particular reference to rubber and tin; (b) permitting longer officer procurement under the European Recovery Program; (c) opening additional areas of competition in the United States to natural rubber; and (d) removal of administrative barriers to imports arising from customs procedures. It may be pointed out, however, that the last two measures tend to shift demand away from American products and have a minor downward effect upon U. S. business activity. To that extent, they reinforce the case for expansionist domestic measures.

Recommendations

1. Acceleration of the Point Four Program.

The first and most important action that can be taken is to inject new life into the Point Four Program by offering now to make large scale
developmental loans to be drawn on over the next five years, to some of
the underdeveloped countries of Asia and the Near and Middle East, of
which India is the most important. So far as India, Pakistan, and Egypt,
which hold large sterling balances, are concerned, the character of these
loans should be related to the willingness of these countries to arrange
with the British to reduce or stop entirely their drawings on blocked
sterling balances for the next five years and, if possible, to fund the
rest of these balances.

This proposal has the following merits:

(a) The loans will increase American exports, production, and em-
ployment. Not only the part the borrowers spend here but the part they
spend in Europe and elsewhere will affect American exports. In fact if
the underdeveloped countries buy capital goods in Europe, the additional
American products Europe will buy may include some, such as cotton and
tobacco, that cannot be helped in any other useful way. The cost of
Government support operations and the real waste involved in producing
commodities that are not consumer would thereby be reduced.

(b) With British and other European goods cheaper in relation to
American goods than before devaluation, the contribution that Point Four
investment can make to European viability is vastly increased. Prior to
devaluation, price relationships were such that loans to underdeveloped
countries would probably have been spent predominantly in the United
States. The new price relationships, however, make European capital goods
much more attractive. Point Four loans, therefore, besides contributing
to the economic development of the underdeveloped areas, can now mean a
very substantial increase in the dollar income of Europe. Thus both the
aims of Point Four and CEP are promoted. Since Europe will still be short
of dollars and will spend these earnings in the United States, the second
aim is promoted without reducing the effectiveness of these loans in stim-
ulating U. S. exports, production and employment.

(a) Great Britain's dollar problem is further alleviated by using
the conditions or size of the loans as a lever to reduce the burden on
her of releasing sterling balances to her creditors. Under present ar-
rangements, India, Pakistan, and Egypt are expected to draw on their
sterling balances to the extent of over 600 million dollars in 1946-49.
This constitutes a drain on the British in the form either of dollars
or the shipment of goods for which Britain gets nothing in return. Dolar
loans to India, Pakistan, and Egypt would make it possible for them
to stop drawing upon the sterling area dollar pool or to pay for British
goods in dollars instead of by drawing on sterling balances. With a
simultaneous cut in sterling releases and loans to these countries, either
the British would be able to make these goods (or the resources they use
up) available for exports to the dollar area, or they would be able to
sell them to these creditors for dollars instead of for a mere reduction
in their sterling debts.

(d) The acceleration of Point Four investment is made especially
desirable from the point of view of foreign policy by developments in
China, which endanger political stability in the whole area of South-
eastern Asia. The extreme inequality of income between these countries and the Western world is one of the most explosive facts of the modern world. In India, for example, average per capita income in 1959 is estimated at 34 dollars. Life expectancy at birth was 37 years. Large scale development loans to India, Indonesia, and other countries in this area, aspiring to raise their standards of living by developing their resources, will deprive the Communists of most of their appeal to the native populations. The beneficial effects will be greatest if the developmental loans are made to the maximum extent possible through international machinery so that charges of American imperialism are minimized.

(a) Extension of such loans to the Middle East can contribute to 
removing much of the economic basis of unrest and friction between countries of the Middle East.

(f) Loans to underdeveloped countries in Asia would increase the 
market for Japanese textile products and assist the recovery of the Japanese economy. This would reduce the burden upon us of Japanese occupation costs and also increase the market for our raw cotton, reducing the burden of government support operations. Of themselves, these reductions in government expenditure would tend to offset a small part of the stimulating effects of the loans on American employment and production, but they would provide an opportunity for corresponding tax reduction or expansion of more productive public programs. Thus there need be no offset at all to the stimulating effect upon U. S. production and employment and there would be an opportunity for a more constructive use of our resources.
The main problem here is to keep as large a portion of such loans as possible on an international basis. It is also desirable to put as large a portion of the remainder in a form that can be financed jointly with (or resold to) American private capital, in order to keep down the Government outlay.

The International Bank could be expected to participate in such a program if pressed by the American and British directors. The limitation on its participation would be set by the specific projects it feels are sound rather than by lack of funds. Funds should also be supplied by the Export-Import Bank through purchases of long-term bonds which would be suitable for resale to private investors.

Action looking toward negotiation of such loans should be begun as soon as possible to give the program a push before the next session of Congress begins. The stage will then be set for requesting a substantial addition to Export-Import Bank lending authority, say $6 billion dollars, for use over the next five years in connection with direct loans and the guarantee program that has already been requested.

The desirability, in fact necessity, of public lending as a part of the Point Four program, especially in its early stages, has been recognized by the Department of State, although in public statements they have not been very frank about it. This reticence seems unjustified. According to the confidential results of their own poll, a substantial majority of the public favors a government policy of lending to friendly countries. Of those asked in July if such a policy should be undertaken to "help them
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(i.e. friendly countries) to buy things here; 54 percent approved and
only 33 percent disapproved, the other 8 percent having no opinion. In
August the same question was asked without reference to the loans helping
foreign countries to buy goods here, i.e., "In general do you approve or
disapprove of our government making loans to friendly countries to help
them meet their problems?" Approvals were 69 percent, disapprovals only
28 percent, and 6 percent had no opinion.

2. Change in Export-Import Bank Policy.

A second step is to stop the Export-Import Bank's present practice
of requiring that the proceeds of its loans be spent in the United States.
This has the following advantages:

(a) The present policy of tying loans prevents such loans from hav-
ing the maximum beneficial effect in restoring European viability. If
borrowers can buy capital goods in Europe instead of the United States,
Europe will earn more dollars. European countries, almost without ex-
ception, will use these dollars to buy American goods, so that the dol-
ars will finance our exports but will finance twice as much world trade
as if the loans are tied. With termination increasing the borrowers' in-
centive to buy in Europe, the benefit to Europe's capacity to earn dollars
from abandoning the present policy is vastly increased.

(b) "Unrying" our loans will not have such effect upon the volume
of our exports but the effect upon their composition might be very benefi-
cial. The borrowing countries are not so likely to buy surplus agri-
cultural products from us as are the countries who would obtain the dol-
ars if the borrowers are free to buy where they please.
(c) Tying Export-Import Bank loans will further our general foreign economic policy of promoting multilateral trade and non-discrimination. The present practice is inconsistent with this policy. It has left us open to charges of hypocrisy because, in tying loans, we are engaging in discrimination in favor of our own goods. Our policy is to say that countries should buy goods where they are cheapest but, as long as we tie loans, we are saying, in effect, that so far as Export-Import Bank money is concerned, other countries should buy goods where they are cheapest only if they are cheapest in the United States.

The present policy of tying loans does not seem to be required by a realistic interpretation of the Export-Import Bank Act but appears to result from the Bank's interpretation of the Act. The Act merely states that "The object and purposes of the Bank shall be to aid in financing and to facilitate exports and imports and the exchange of commodities between the United States . . . and any foreign country . . ." Under present conditions of acute and general dollar shortages, this purpose would be carried out by untied loans. As I pointed out in a memorandum on this subject some time ago, all departments and agencies of the Government represented on the IAC, except the Bank itself, seem to agree that the present Bank policy is inconsistent with our general foreign economic policy.


In the beginning of this memorandum it was pointed out that the deflationary effects of devaluation on our imports and some of our exports
would begin to make themselves felt before any counteracting influences upon other exports could begin to operate. The reason for this is that there would be a strong tendency, especially on the part of Great Britain, to use any increase in dollar earnings or dollar savings first for the purpose of replenishing badly depleted reserves and only later to buy more American goods. The date at which Great Britain would be willing to relax restrictions against American goods could be advanced if the British would borrow from the International Monetary Fund in order to get an immediate replenishment of their reserves. We should consider encouraging them to seek such a loan, supporting it with our large vote. Such a loan could be paid off out of the subsequent more gradual increase in dollar earnings and dollar savings. A loan for this purpose would be in the nature of a normal short-term bank credit, which permits the borrower to advance the date of expenditures in anticipation of receipts which he may reasonably expect.

Such a loan would benefit both the United States and Britain:

(a) The initial net deflationary impact of devaluation upon us would be reduced because it would enable the British to relax import restrictions against U.S. goods first and replenish debt-free reserves later, instead of doing these in the reverse order, as they would otherwise have to.

(b) The earlier increase in the flow of goods to Britain would reduce the initial inflationary pressure on the British economy caused by devaluation. It would either permit a given initial limitation of in-
tended price increases to be attained with a less drastic anti-inflationary policy on the part of the British Government, or permit a given anti-
inflationary policy to place a lower limit on the initial rise in the cost of living. To the extent that the benefits were taken in the latter form, such a loan would assist the British Government in resisting wage increases and might thereby have a more than temporary effect in reducing the extent of further price increases.

A loan to the United Kingdom might be in an amount sufficient to restore its official gold and dollar reserves to the March 31 level. On this basis, I should guess that the loan would probably have to be something in the neighborhood of 500 million dollars. The International Monetary Fund could not properly make such a loan before devaluation because there was no clearly temporary element in the British disequilibrium. To the extent of the expected correction in the British balance of payments, devaluation has converted part of this disequilibrium from a "fundamental disequilibrium", against which the Fund may not lend, to a "temporary disequilibrium", against which it may.

The justification for making stabilization loans to the United Kingdom is that they have suffered an extremely acute decline of international reserves. The possibility of making such loans to other countries, however, should not necessarily be ruled out.

The only weakness of this proposal, so far as I can see, lies in the fact that the loan would be made in anticipation of increased dollar earnings and dollar savings arising from devaluation; it may be criticized on the ground that these gains may not occur, or may not be large enough.
Against this, however, it may be pointed out that there are other dollar benefits which are more certain, but which also take time to realize. For example, the increase in gold production, of which the United Kingdom can almost certainly earn a share, and the dollar savings accruing from some reduction of capital flight out of the sterling area.

4. **Strengthening Expansionist Elements of Domestic Policy.**

At the outset of this memorandum it was pointed out that the deflationary effects of devaluation, though not great in relation to the absolute level of economic activity, may be great in relation to the net influence of other forces seeking for economic recovery. This possibility plus our undertaking to reduce administrative barriers and the recent tariff reductions increases the need for expansionist domestic measures. To the extent that the devaluation cuts our export surplus, making goods available at lower prices and in larger volume, it is similar to an increased supply of goods resulting from higher productivity or any other source. The translation of this potential increase in the standard of living into an actual increase calls for a corresponding expansion of total demand.

Such an expansion, by increasing our demand for foreign as well as domestic goods, would contribute greatly to reduction of foreign dollar difficulties, as well as to American production and employment.

Domestic expansion is also desirable to alleviate any serious pressure that may develop to shift out increased imports. Such pressure must
be resisted if devaluation is to make its maximum contribution to putting Europe on a self-supporting basis.

5. Incentives to Protection Against Development.

The possibility of concentrated and protracted difficulties in some industries competing with imports makes it desirable to put renewed vigor into the President's mid-year recommendation that the unemployment compensation system be strengthened by increasing the amount and duration of benefits.

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The foregoing recommendations constitute a program appropriate to the international and domestic requirements of the post-devaluation situation. It requires no new legislation in this session of Congress, except in connection with unemployment compensation, for which new legislation has already been requested. The program also does not go outside the framework of our existing economic policy with regard to aid to Europe but helps Europe within that framework. At the same time it has the advantage of promoting the success of our long-run commercial policy and our general foreign policy.