AUSTRALIA AND THE "DOLLAR GAP"

The negotiations successfully concluded by the Prime Minister for a loan of $100m. from the International Bank for Reconstruction and Development have been widely applauded. The loan, together with the prospect of a further $150m. within the near future, will enable Australia to obtain vital equipment—especially for large-scale developmental and industrial projects—which is at present unobtainable from the soft currency areas. The dollar loan can therefore be justified as an important step toward developing Australia's productive capacity and thus assisting the economic absorption of the great flow of migrants. It has also been claimed that the loan will help to counter inflation, but its immediate influence in this direction is likely to be insignificant.

Interest and capital repayments on the loan, which will commence in 1956, will amount in the first instance to $7,356,000 a year. This amount will, of course, substantially increase if the expected additional loan of $150m. eventuates, and we must anticipate that the burden of servicing the newly acquired dollar debt will in due course be of the order of $15m. to $20m. a year.

This is by no means a negligible amount; it would represent about 15% of Australia's total dollar exports on the basis of the average of the last three financial years. The task of repayment will, however, be greatly simplified if by 1956 the sterling-dollar gap has been bridged and sterling is again freely convertible into dollars—assuming, of course, that world demand for Australian exports is well maintained. In that event Australia would be able to finance repayment of the loan out of its earnings of sterling.

Australia has always been a large debtor on dollar account, but before the war we were generally able to buy our full dollar requirements by using our earnings of sterling to cover the deficit on direct dollar trading. Notwithstanding the dollar loan we will be compelled to continue restrictions on dollar purchases until multilateral trade has been restored and sterling is again a freely convertible currency. The solution of the Australian dollar problem and the removal of restrictions on dollar imports therefore depend entirely on the solution of the dollar shortage of the whole sterling area.

It is therefore of some interest, in connection with the dollar loan, to examine the Australian balance of payments with the dollar countries and the relationship of our own dollar problem to that of the world dollar shortage.

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For the three pre-war years, 1936/7 to 1938/9, Australia had an adverse balance of **commodity** trade (excluding gold) with the U.S.A. and Canada amounting on average to $70m. a year. This, together with dollar expenditure on "invisible" items such as freight, insurance, tourist expenditure, film remittances, dividend and interest payments, entailed a total dollar deficit of the order of $120m. The size of this deficit did not matter very much for under the pre-war system of multilateral trading our main concern was not to balance our account with each individual country, but to achieve an overall balance. So long as sterling was freely convertible into dollars there was virtually no dollar problem as far as Australia was concerned;

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but with a serious deterioration in the ability of the sterling area to meet its dollar commitments during the war and postwar period all this has been changed.

The free exchange of sterling for dollars has been suspended—except for a temporary relaxation in 1947 to meet the terms imposed by the American loan to the United Kingdom. This action resulted in a tremendous drain on the dollar reserves of the sterling area, and very severe economies were re-imposed in all sterling countries. Australia was forced to introduce extensive restrictions on dollar purchases—petrol, newsprint, motor chassis, cotton and textiles—which aimed at cutting our total dollar imports by 20%. Restrictions were also imposed on items such as films and travel and special efforts were made to boost our exports to the dollar areas. With the sharp drop in the dollar reserves of the sterling area in 1949, further heavy economies were made at the time of devaluation.

The success of this policy can be gauged from the following table:—

Aust. Balance of Trade with the Dollar Area.

	1946/7	1947/8	1948/9	1949/50
U.S.A. and Canada		U.S. $ million		
Exports	170	129	132	137
Imports	189	274	181	173
Adverse Balance of Trade	—19	—145	—49	—36
Balance with other American account countries	4	—	4	5
Adverse Balance with the Dollar Area	—15	—145	—45	—31

Source: Commonwealth Statistician.

Latest details of the "invisible" items in the balance of payments both on capital and current account are not yet available, but the following statement, prepared by the Commonwealth Statistician gives a comparison for the three years 1946/7 to 1948/9.

INVISIBLE ITEMS	1946/47	1947/48	1948/49
	U.S. $ million		
Freight on imports	—35.4	—43.2	—26.7
Insurance on imports	— 2.5	— 3.5	— 2.1
Expenditure by Australian travellers	— 4.8	— 3.3	— 2.2
Expenses of Australian companies in N. America	— 1.2	— 1.3	— 2.7
Film remittances	— 6.6	— 4.7	— 3.6
Profits and dividends remitted	— 7.4	— 7.7	— 9.3
Undistributed income accruing to North American companies	(a)	— 7.1	—10.7
Public authority interest payments	—10.7	— 9.3	— 9.2
Lend-lease settlement and purchase of U.S. surpluses	—20.0	— 2.2	—
Other miscellaneous debits	—20.6	—22.3	—31.0
Miscellaneous credits	34.7	17.9	23.0
Invisible balance with the Dollar Area	—75	—87	—75
Trade Balance with the Dollar Area	—15	—145	—45
BALANCE ON CURRENT ACCOUNT	—90	—232	—120
CAPITAL ACCOUNT			
Increase in debt of public authorities	— 1	—	— 2
Identified private capital inflow (including undistributed income)	(a)	26	23
Errors & omissions (mainly capital movements)	35(a)	10	— 4
BALANCE ON CAPITAL ACCOUNT	34	36	17
EXCESS OF DOLLAR DEBITS OVER DOLLAR CREDITS	—56	—196	—103
DOLLAR FINANCING			
Gold Sales to United Kingdom	—	30	32
Estimated dollar drawings from Sterling Area Dollar Pool	54	164	73
Decline in dollar balances ..	2	2	—2
TOTAL	56	196	103

(a) No estimate is available for identified private capital inflow in 1946/47. Undistributed income is excluded from both current and capital account and other private capital inflow is included in the item Errors and Omissions.

It is anticipated that the invisible balance on current account for 1949/50 will be within $5-10m. of that for 1948/9. On capital account two local government loans amounting to $9m. were repaid in 1949/50, but no information is yet available regarding private capital movements.

As Australia sold about the same amount of gold to the United Kingdom as in 1948/9 and drew $20m. from the International Monetary Fund, the movement in our dollar balance was again negligible.

The great proportion of our current earnings of dollars are derived from exports of wool, other primary products and metals. Out of £59m. (Aust.) received from exports to Canada and United States in 1949/50, wool contributed £45m. Other exports include dried fruits £2m. and raw sugar £1m to Canada; and sheep skins £2m., rabbit skins £1½m., pearl shell £¼m., pig lead £1m., ores and concentrates £1½m. to the United States. Australia also exported £1¼m. worth of foodstuffs to Canada and the United States, consisting mainly of sausage casings, frozen rabbits and lobster tails.

Although Australia's adverse balance of trade with the dollar area has been brought back to fairly manageable proportions through import economies we still have a large expenditure on non-trade items and, on present indications, can seldom expect to balance our account with North America out of our own resources. We will still depend on the account being balanced by the sterling area as a whole and the correction of the chronic world dollar shortage.

World Dollar Shortage.

Why has the world been so short of dollars?

There are several reasons, all arising directly from the war itself. The ability of the European countries to produce goods for export was disastrously impaired by the large-scale destruction of their productive capacity during the war. Great plants were wiped out, transport systems destroyed and dislocated, shipping and docking facilities severely damaged and agricultural lands laid waste. In the early years after the war it was a sheer physical impossibility for the countries of Western Europe to produce goods for export on the scale required to maintain reasonable standards of living and to reconstruct their battered industrial machines for peace-time purposes. This problem was of course aggravated by the fact that the economies of these countries had been totally turned to the production of munitions and goods essential for the war, and the process of reconversion to peace production was necessarily slow and difficult.

There were other reasons. Before the war European investments in the dollar countries were a large source of dollar income, but during the war a big proportion of these investments had been sold in order to obtain funds to finance the purchase of munitions and essential war supplies. In addition, shipping, which had been an important dollar earner before the war, had been drastically reduced by the war and could not be rapidly rebuilt.

The dollar income from shipping and investments in the years before the war was sufficient to pay for about 30% of the total dollar requirements of the European countries. This meant that only 70% of their imports from the U.S. had to be covered by exports to the United States. But by 1947 this position had been radically transformed; and the consequence of the loss of dollar earnings from shipping and investments is that Western Europe now has to earn a much larger proportion of her total dollar requirements by the direct export of goods to the United States. In 1947 the Western European countries were able to earn from exports and other sources only 40% of the dollars needed to pay for their imports. The remaining 60% was provided by United States Government Aid, by further liquidation of assets held in the United States, and by sales of gold.

Moreover, superimposed upon this deterioration of their dollar-earning capacity was the fact that the war made these countries dependent on U.S. production

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to rebuild and reconvert their economies for the purposes of peace. Thus: "The rest of the world became more than ever before dependent upon American resources and was less than ever before able to pay for its imports from the United States."*

Since the end of the war the dollar exports of the countries of Western Europe have fallen a long way short of the amount necessary to pay for even their minimum requirements from the United States. The gap has been bridged in part by American loans—notably the Anglo-American loan of 1946—and, since 1948, by assistance under the European Recovery Programme (widely known as "Marshall Aid") which consists in the main of free grants-in-aid.

Prospects of the Marshall Plan.

Since 1948 the Marshall Plan has been the chief means of bridging the gap. The basic intention of the Marshall Plan was to provide the countries of Western Europe with the time, materials and equipment needed to reconstruct their economies and increase their production, and thus their dollar exports, to the point where a resumption of normal trading relationships would be possible. When the Marshall Plan was launched, it was hoped that by 1952 these countries might be in a position "to pay their way" by their own efforts and without the continuance of extraordinary assistance from the United States. Before the position was obscured by the Korean War, it was generally accepted that this objective was unlikely to be attained. (The Korean war has greatly increased United States purchases of strategic materials and has temporarily relieved the acute nature of Europe's dollar deficit.)

Spectacular progress has been achieved in all the European countries since the commencement of Marshall Aid in 1948. Indeed, Paul Hoffman, the head of the European Co-operation Administration went so far as to say early this year: "The recovery of industrial production, built almost literally from the ashes of World War II, has been a near miracle."

*Quoted from a report prepared for the National Association of Manufacturers of the U.S.—"The Foreign Trade Gap."

The 1949 Crisis and Devaluation.

The ground gained, however, has not been easily won, nor without temporary reverses of a serious kind. In 1949 the dollar deficit of the sterling area countries increased rapidly and the gold and dollar reserves of the United Kingdom began to dwindle alarmingly. This situation led directly to the devaluation of the £ sterling in September, 1949, from the previous rate of $4.03 to the £ to the current rate of $2.80 to the £. Part of the cause of the drain on the U.K. dollar reserves was the slight economic recession which took place in the United States itself and which continued throughout 1949. The effect of the recession was to reduce United States purchases from (and thus the dollar earnings of) Europe and the rest of the world. The events of 1949 serve to show the great extent to which a continuance of the improvement in the dollar position of the last few years, and indeed an eventual solution of the dollar problem, are dependent upon the maintenance of high-level business activity in the United States.

Ultimate Closing of the Dollar Gap.

Notwithstanding the temporary relief being provided by the impetus to expanding defence expenditure arising from the Korean war, the long-term difficulties must still be overcome. How will the gap eventually be bridged? Probably by a combination of methods! A great deal of hope is being placed on the expansion of overseas investment by private investors in America. Reports published by the National Association of Manufacturers of the U.S. suggest that by 1952

American private capital will probably be prepared to go abroad in large amounts, and that possibly $2 billions a year will be available for this purpose. This would obviously make a very material contribution to the solution of the problem, but, if it is to be realised, positive steps will have to be taken to create conditions attractive to private investors. The essential conditions are that American capital invested abroad should be free from the fear of expropriation and from excessive rates of taxation, and that proceeds of investments should be readily convertible into dollars.

In the long run, the solution of the dollar problem will demand that the United States accept the need for greatly increased imports from the rest of the world. This will become all the more necessary as interest and capital repayments of overseas loans become due and as expanding investments of private capital have to be serviced by the payment of dividends. If the overseas dollar account is to be balanced the United States will, in fact, have to become a "net importer." This is inherent in her position as a creditor nation and there seems no escape from it.

Are the American people ready to accept the implications of this position? The signs are not altogether unpromising. The ground work for a revolution in American opinion is being laid by the educational work of Paul Hoffman and the organisation which he heads, and by articles in leading American papers and periodicals. But perhaps the most striking manifestation of a change of opinion is to be found in a report entitled "The Foreign Trade Gap," prepared for and published by the traditionally high-protectionist National Association of Manufacturers. This report published last year, categorically states the necessity for the United States to develop eventually an "import surplus"—in other words to import more than she exports.

The success of all plans for the solution of the dollar problem is conditional upon the avoidance of economic depression within the United States itself. A serious depression in the United States would deal a heavy blow at economic stability throughout the world, and would constitute a severe setback to hopes of overcoming the dollar shortage and the restoration of sterling convertibility.