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**The Soft Option of the
Reserve Currency Status**

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by

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The dilemma inherent in any national currency serving as international 'money' should be part of conventional wisdom by now. In order to maintain international confidence in the national currency, monetary liabilities abroad must increase rather slowly in relation to the reserve assets of the country. For this to be feasible over time, the country must not run continuous, large current account deficits, implying, by and large, excess demand for that currency at least on global current account transactions. However, this requirement for the reserve currency status of the national currency may come directly into conflict with its role as an international unit of account and medium of exchange in so far as excess demand for that currency also implies inadequate provision of 'international liquidity' for purposes of global trade and transactions. To err on the side of excess supply by running current account deficit may be a easy way of solving the problem of shortage of international liquidity. In short, between the regime of excess demand for the national currency required for maintaining its reserve currency status as the international 'store of wealth' and, the regime of excess supply needed for maintaining adequate international liquidity for transaction purposes, the zone of equilibrium characterized by zero excess demand or supply of the reserve currency may be so narrow as to be virtually non-existent for practical policy purposes.

The dilemma was clearly recognized by Triffin (1961) even in the early years of the Bretton Woods arrangement. The U.S. trade surplus declined quite rapidly -- from \$ 10.1 billion in 1947 to \$ 2.6 billion in 1952, while capital outflows (lending and transfer in the form of aid and grant) were maintained at relatively high levels. The result was a net deficit; some say (e.g. Solomon, 1977) it emerged as early as 1950. Nevertheless, this was hardly recognized as a normal payments deficit; both the IMF Annual Reports and the Federal Reserve Bulletin of that time coined the expression, "net transfer of gold and dollars to the rest of the world" to describe such payments deficits. Nevertheless, signs of the long-run problem should have been unmistakable. The U.S. balance of payments deficit in the above sense averaged \$ 1.1 billion a year from 1949 to 1959, of which \$ 5.7 billion was met from U.S. gold sales to the foreign countries. The "Triffin dilemma" was already making its appearance: if the process continued, the U.S. reserve liabilities would increase relative to her reserve assets. This would mean declining net reserve eroding confidence in dollar holding abroad. On the other hand, if U.S. deficits could be eliminated, a major source of growth in world liquidity under the Bretton Woods arrangement would dry up, with depressing effects on world trade and economic activity. This dilemma of the dollar to which Triffin drew attention was historically unique only in so far as the agreement at Bretton Woods represented a conscious attempt for the first

time to lay down the rules of the international monetary system. By raising the national currency of the United States to the status of international money, these rules recognized explicitly the realities of the post-war balance of power among the capitalist nations based on the hegemonic role of the United States. But from another point of view it represented historical continuity with the classical Gold Standard era (1895-1914). The Bretton Woods arrangement resembled closely that earlier historical pattern of international financial relations in so far as they had also evolved from the hegemonic role of Britain in the world economy.

The Gold Standard was based on an appealing principle. In theory, it implied a symmetric mechanism of adjustment among the trading nations for automatically correcting surpluses and deficits in trade balance.¹ A country running a trade surplus was supposed to experience net inflow of gold which in turn would lead to a corresponding expansion in the domestic money supply linked to the stock of gold held by its monetary authority. According to the postulates of the prevalent Quantity Theory of Money, this larger money supply was expected to result exclusively in higher prices (without any Keynesian adjustment in real output and economic activity) including a higher price level for goods exported by the surplus country. This would lead to lowering its price competitiveness in the international market

leading to declining exports and rising imports until the assumptions like sufficient response of export and import to price change (e.g. the Marshall - Lerner condition) are needed to make this adjustment mechanism work smoothly over the relevant time period. But without going into these logical refinements, it is clear that the ideology of the Gold Standard appealed to an automatic adjustment mechanism that symmetrically operated in both the surplus and the deficit countries. Thus, the deficit country experienced gold outflow and falling price of export induced by lower domestic money supply until it regained sufficient price competitiveness in the international market to close its deficit.

The most comforting feature of the equilibrating mechanism was its symmetrical nature already mentioned. Supposedly the adjustment through the international price mechanism applied with equal force to both the surplus and the deficit country irrespective of their international economic power. Not surprisingly, the theory was very different from actual practice. In practice, the Gold Standard operated in quite a different way even during its peak period (1895-1914) when all the major countries adhered to it.² Undoubtedly, the mechanism of automatic adjustment outlined above was theoretically flawed in many ways. As Keynes was to teach later, a higher money supply could lead to adjustment in output rather than price through (say)

lowering the interest rate and thereby, stimulating investment and effective demand. Again, the price mechanism could work only if the relevant "trade elasticities" were sufficiently large within the relevant time period (recall the J - curve phenomenon often associated with devaluation in recent literature). But far more important than these theoretical flaws was the political presumption that the international adjustment mechanism operates independently of the uneven distribution of economic power among the trading nations. Thus, the basic postulate that deficits and surpluses in trade lead to corresponding outflow and inflow of gold was true only for the economically less powerful nations. It had little relevance for Britain. As the most powerful industrial and financial nation of the time, the debt obligations created or underwritten by the British government enjoyed unquestioned international confidence. As a result, Britain was seldom required actually to liquidate her debt obligations by paying in gold to foreign governments. Instead her mere promise to liquidate in gold her financial liabilities was considered "as good as gold". This permitted Britain to escape the basic discipline of the Gold Standard according to which her financial liabilities should have been strictly backed by gold held by the monetary authority. In truth, Britain followed an altogether different policy which amounted to manipulating rather than subscribing to this discipline of the Gold Standard. The

essence of this policy was manipulation of the interest rate to regulate inflow and outflow of gold:

"The Bank of England kept very little gold (in relation to money supply) -- some say because gold yielded no interest while others are more charitable. Whatever the reason, the consequence was that the Bank was forced to react to slight losses of gold, changing the Bank Rate an incredible number of times per year". (Lewis, 1977; pp.47-8).

The Bank of England could manipulate the Gold Standard simply through its interest rate policy precisely because international confidence in the sterling and sterling-denominated assets was nearly absolute. Foreign creditors were willing to hold sterling-denominated assets bearing interest income instead of barren gold. In effect, this assigned to the British sterling its international role as the 'proto-reserve currency' during the Gold Standard era.

When a national currency is elevated to the role of an international reserve currency, whether under the Gold Standard or under the Bretton Woods System, it bestows on that nation a special privilege. It is the privilege to escape a national "budget constraint". For any country, its excess of expenditure on goods and services over domestic income (= nominal output) would show itself in terms of a corresponding deficit in the international balance of trade, i.e. investment - saving \equiv import - export \equiv trade deficit. Normally, the budget constraint of a country means that it

will be forced to cover the trade deficit by running down its international reserves. However, the reserve currency status would permit a country to cover the same deficit by increasing simply its monetary liabilities abroad. And, this process of financing deficit can go on so long as foreign creditors continue to have sufficient confidence to hold such monetary liabilities as their international reserves without wishing to convert them into gold (under the Gold Standard) or some other currency. In other words, until the reserve currency status of a national currency is questioned by foreign creditors, the country faces no constraints regarding its level of domestic expenditure.

A comparison with the traditional Keynesian analysis of the closed economy may be instructive at this point. The institution of credit money, like international credit, also permits "capitalists" to undertake investment expenditure independently of the savings plan of the "households". But in a demand-constrained economy, such investment becomes self-financing in so far as higher investment generates higher income and higher saving to match that higher level of investment. Extension of the same line of argument to international credit however, could have a different consequence in so far as the gap between expenditure and income of an open economy may be sustained at least partially by borrowing abroad and allowing import to rise

disproportionately rather than through income adjustment at home.³

The implication of the preceding argument is that, the reserve currency status has an almost paradoxical consequence for the demand side of the domestic economy. On the one hand, it allows domestic demand to expand without a balance of payments (or budget) constraint. But, on the other, the greater is the increase in monetary liabilities abroad for covering the payments deficit, the larger is the leakage of home demand into the foreign market to weaken the stimulus from demand to domestic output expansion through the foreign trade multiplier.

It follows from this argument that the dilemma of using any national currency as the international reserve or proto-reserve currency runs even deeper than visualized originally by Triffin. The privilege of the reserve currency status can continue over time only if that privilege is not exercised! A continuous current account surplus implying excess demand for the reserve currency is a sufficient condition for attaining this. But this not only implies a shortage of international liquidity as Triffin had visualized, but even more significantly, it implies domestic austerity and restraint on aggregate demand despite the privilege of unlimited borrowing abroad. It is hardly surprising that neither Britain in the era of the Gold Standard nor the

United States under the Bretton Woods system could stay long on such a narrow path of virtuous austerity.

An analysis of the broad historical trends in the British balance of payments indicates that the proto-reserve currency status of the sterling managed to hide for quite a long time the relative weakness of British manufacturing industries compared to her trade rivals in the world market. It is useful to begin by noting that the export surplus enjoyed by Britain was primarily on account of invisible rather than visible trade since at least 1880s.⁴ The relative importance of the different sources of invisible export earning went through interesting changes throughout the 19th century. Initially, British shipping was the most important source. But by 1875, overseas investment income in the form of interest and dividend followed by another item classified as "profits of foreign trade and services" occupied quantitatively the most important position. This marked rise in the importance of income from international accumulated investment and financial transactions is further underlined by the fact that from the second half of the nineteenth century a significant fourth item of invisible export gradually acquired greater quantitative importance; it was insurance earning, brokerage commission etc.

The overall strength of the British balance of payments position on current account during the Gold Standard era derived mostly from the international earnings associated with various financial services and foreign investment income. Earnings on these invisible accounts rather than the superior export performance of the manufacturing sector helped to sustain international confidence in the proto-reserve currency status of the sterling. Nevertheless, this relatively poor export performance of the domestic manufacturing sector in the country which initiated the industrial revolution in the modern world requires at least some tentative explanation. Perhaps part of the explanation lies in the disproportionate growth of foreign, compared to domestic, investment which starved the domestic industrial sector of its much needed rationalization and expansion.

It is significant that Britain's annual foreign investment began to exceed her domestic investment on an average, from as early as 1870. During the Edwardian era foreign investment continued to rise despite a declining trend in domestic investment and, this 'scissors' crisis' of rising foreign and stagnant to falling domestic investment reached its peak during 1911-13. By 1913 foreign investment was more than twice as high as domestic investment. The enormity of the programme of British overseas investment spanning nearly half a century up to the outbreak of the

first world war can be judged from the fact that throughout this period it averaged around 4 per cent of her national income. After the turn of the century, between 1905 and 1913, this rose to an average figure of 7 per cent. British capital overseas increased from Pound Sterling 1,000 million in 1870 to nearly Pound Sterling 4,000 million in 1913; nearly 3/4th of it was accounted for by British investment in public utilities (especially railways) and British loan to other governments.⁵

It is difficult to discern to what extent this foreign investment was politically rather than economically motivated. In the classical Marxist literature (e.g. Hilferding, 1981; Lenin, 1979), it is suggested that at least part of the foreign investment was directed towards finding cheap sources of raw material for domestic industries. In this sense, there could develop a kind of mutually cooperative relation between the domestic industrial base and foreign investment, in so far as the latter lowers production cost through cheap supply of raw materials. There is some apparent geographical evidence in favour of such a thesis. Britain increasingly directed her overseas investment to the 'new' countries or settlements which formed part of her formal or informal empire. As a result, these new areas came to account for 45 per cent of accumulated British overseas capital in 1913 compared to only 10 per cent in 1870. Its counterpart was the sharp

decline in the percentage share of British capital in Europe, from nearly 50 per cent in 1870 to as low as 5 per cent in 1913, whereas the share of British capital in the United States more or less stable at 20 per cent.⁶

Nevertheless, the fact remains that foreign investment did not put domestic manufacturing industries in a particularly advantageous international competitive position. Britain's dependence on import grew at a considerably faster pace throughout compared to either her (visible) export or her real income. Suffice it to mention here that during the course of the entire century (1815-1914), real income increased about 10 times, import increased 20 times and, the ratio of import to national income grew from 12 to 30 per cent.⁷

At the same time the gap in visible trade continued to widen markedly as visible exports grew only at a slightly higher rate than real income. A clear, broad historical tendency became increasingly unmistakable. The sustainability of the proto-reserve currency status of the sterling depended critically on invisible trade surplus, but not on the superiority of the manufacturing industries as the most important component of visible trade.

The British experience until 1914 was indicative of two interrelated problems. First, it showed the possibility of

sustaining international confidence in the proto-reserve currency status of the British sterling through financial rather than trade openness. Because, the surplus on account of invisible trade was largely the consequence of international financial transactions. Second, international financial openness operated to the advantage of Britain precisely because, the sterling was international money, serving both as a medium of transaction and as a store of wealth, i.e. the proto-reserve currency of the Gold Standard system. As a broad analytical generalization, it may be concluded that the proto-reserve currency status of the sterling began to make contradictory demands on the British economy even prior to the outbreak of the first world war. Her relative weakness in manufacturing required her to rely increasingly on the captive market of the Empire rather than on international competition. The result was to move away from free trade and, a lower degree of openness in (visible) trade. On the other hand, her financial supremacy could be exploited more fully through greater international financial openness.

These two opposing tendencies came to a head to upset the delicate balance with the outbreak of the first world war. Britain's war expenditure meant giving up earlier restraint on aggregate domestic demand by taking recourse to the proto-reserve currency status of the sterling. As a result, Britain's monetary liabilities abroad grew rapidly

to finance the war expenditure. As a result, France and the United States became the two largest holders of Britain's sterling liabilities by the end of the war.

Along with this was another parallel development. With the outbreak of the war, all major industrial countries were forced to suspend the convertibility of their currencies to gold in order to finance their war expenditures. As a matter of expediency, Central Banks were compelled to hold several major currencies in reserve, instead of only gold and sterling, in order to settle international payments. This gave rise to the Gold Exchange Standard in which several national currencies enjoyed simultaneously the reserve currency status to varying degrees. For Britain, it was a retreat.

In an attempt to regain the pre-war supremacy of her currency, Britain prematurely returned to the Gold Standard in 1925, pegging the pound at the old pre-war rate of gold parity. Maintaining the dominant position in international finance badly required the image of a strong national currency. And, this was further complicated by the fact that Britain could not regain her invisible export surplus without the sterling regaining its international status. Equally badly, however, industry required to improve its export competitiveness with large unemployment and stagnant demand at home since the end of the war. Winston Churchill

as the Chancellor of the Exchequer was forced to observe: "the Governor (of the Bank of England) shows himself perfectly happy in the spectacle of Britain possessing the finest credit in the world simultaneously with a million and a quarter unemployed....I would rather see Finance less proud and Industry more content."⁸

Thus, the latent opposing tendencies of the pre-war years -- the contradictory requirements of domestic industry and international finance -- came to be posed without ambiguity in the post-war years. The objective of a strong and stable national currency was counterposed against the objective of high activity and employment in domestic industries. Only when Britain was forced to abandon the Gold Standard in the summer of 1931, the prestige of the city as the centre of international finance was sufficiently discredited, at least temporarily, to make arguments in favour of domestic industry and employment politically more acceptable. Keynesian style demand management, designed to defend the level of employment in domestic industry against the depressive influences of an over-valued national currency could find political acceptance only under those circumstances. (Kindleberger, 1973; Bhaduri and Steindl, 1983).

The collapse of the proto-reserve currency status of the sterling brings into sharp relief the dilemma that is

inherent in such a situation. So long as aggregate domestic demand was relatively restrained and Britain maintained (up to the first world war) a current account surplus, mostly due to a large invisible export surplus, the reserve currency status of the sterling went unquestioned. But this also meant not exercising fully the privilege of the reserve currency status and, actually letting the sterling be in excess demand, i.e. over-valued in a broad sense to maintain international confidence. Such over-valuation of the sterling probably contributed to the erosion of international competitiveness of domestic industry prior to the first world war in Britain. But even more telling is the fact that, once Britain exercised the privilege of the reserve currency status of the sterling on a large scale to finance her war expenditure, the sterling was in excess supply. Manifestly large and strategically held sterling liabilities abroad eroded confidence in the sterling and ultimately led to its collapse. The dilemma of the reserve currency -- it provides the 'soft option' of no budget constraint on national expenditure in the form of a balance of payments constraint only so long as this soft option is not used -- became the central theme in this experience of the collapse of the sterling in 1931. And, the United States was to repeat the same experience, only with some minor variations, a few decades later.

This particular aspect of the U.S. experience is most dramatically illustrated by the fate of the dollar. Other major industrial economies made the transition from a situation of acute 'dollar shortage' in the immediate post-war years (approximately, 1947-53) to full convertibility of their currencies into dollar (mostly by 1958) and ultimately, a situation of 'dollar glut' which forced the United States to abandon unilaterally the official convertibility of dollar into gold in 1971 and the collapse of the Bretton Woods system of 'dollar standard' in 1973.

Arithmetically speaking, this process of transition was driven by a systematic exercise of the 'soft option' over time. Aggregate demand, by and large, continued to outstep domestic income in the United States to result in steady international payments deficit. This was covered by accumulation of monetary liabilities of the United States abroad and through a gradual erosion of the U.S. stock of reserve assets. The combination resulted in a steady decline in the international liquidity position of the United States over time.

A more disaggregated view of the U.S. international transactions presented in Table 1 shows that net merchandise export begins to decline quite sharply from the second half of 1960s and within a decade, from 1976 onwards, it is in persistent deficit. Like in the case of the British balance

of payments in an earlier period, net investment income is positive and sufficiently large to cover merchandise deficit until about 1980-81. But after 1981, the deficit on merchandise trade can no longer be covered by net investment income. One might even say that the U.S. economy undergoes almost a mutation as net investment income turns negative in 1987, as a result of the international investment position of the United States actually turning negative in 1985 (Table 2). The consequence of the U.S. gradually turning from a net creditor to a net debtor in the world economy means that investment income can no longer provide the required support to any deterioration in merchandise trade balance. Also note that military transactions was a serious drain on the balance of payments position during the Vietnam war (especially, 1966-72), when net deficit on that account exceeded 3 billion dollars per year on an average. However, military transactions as a proportion of total international transactions of the U.S. economy has been falling and cannot directly explain her deteriorating balance of payments position in later years. The basic explanation must lie in a worsening merchandise trade balance and gradual erosion of her international investment position over time.

The decline in the international confidence in the dollar since the early 1960s, however, cannot be inferred directly from the statistics on international transactions of the United States precisely because, the reserve currency

status of the dollar permitted domestic expenditure to outstep income through the exercise of the 'soft option'. This may be brought out more clearly by comparing domestic investment with domestic savings (net) as proportion of GDP and treating the trade balance as an independent variable. This amounts to interpreting the gap between domestic expenditure and income net of trade balance as being largely met through erosion of international reserve of the U.S. and an increase in her monetary liabilities abroad. As Table 3 shows net savings decreased perceptibly in the U.S. economy while gross capital formation remained relatively steady at around 18 per cent of GDP. Even allowing for capital consumption⁹ (depreciation), trade balance could never cover this gap between domestic expenditure and income since 1960. The result was both erosion of international reserve and increase in U.S. monetary liabilities abroad. The latter, in so far as they were held by foreign monetary authorities (as foreign exchange in other central banks), contributed also to the expansion in total international reserve while the international reserve held in the U.S. tended to decline as a proportion of that total international reserve (Table 4).

The erosion of the international reserve position of the United States was both the cause and the consequence of the reserve currency status of the dollar. The exercise of the 'soft option' of taking advantage of the reserve currency status of the dollar to meet excess domestic demand

allowed artificially high consumption levels in the U.S. without cutting down of investment (Table 3). And yet, at the same time, the very exercise of that soft option meant widening deficit in international payments and rapidly worsening 'net worth' of the dollar in terms of international reserves (Table 4). Already in 1961, for the first time, official foreign dollar holding came to exceed the value of U.S. gold and foreign exchange reserves, making net reserve marginally negative. By 1965, reserves were \$ 15.5 billion and liabilities \$ 25.2 billion and, at the time of informal collapse of the Bretton Woods system in 1971, the reserve figure was \$ 13.2 billion against liabilities of \$ 67.8 billion (Brett, 1985; pp.111-119). Thus, the ratio of international reserve to dollar liabilities held abroad came down from a spectacular 2.7 in 1950 to slightly less than 1 in 1961 and even less than 0.2 in 1971. Clearly, the stage had been well set for the collapse of the role of the dollar as the official reserve currency of the Bretton Woods system by 1971.

It is interesting to speculate whether there is some pattern of 'historical inevitability' in the more or less common fate of the British sterling as a proto-reserve currency of the Gold Standard and the American dollar as the reserve currency of the Bretton Woods system. In theory, it is valid to argue that the soft option of overspending through accumulation of monetary liabilities abroad can be

avoided, just as it is possible to argue that an ideal dictatorship can avoid the corruption of absolute power without the inefficiencies arising from the checks and balances of a democratic system. But the fact remains that neither Britain nor the United States managed to avoid it in practice. Compulsions of political supremacy that usually goes with the reserve currency status of a national currency tends to make that national especially prone to military expenditure in critical times through the use of the soft option.¹⁰ There is perhaps even a deeper logic in so far as the international reserve currency role of the national currency requires a strong and steady currency, whereas the very exercise of the soft option of overspending abroad entails large leakage of domestic demand into the foreign market, enfeebling domestic industry from at least the demand side. In order to suit the image of the reserve currency role, compulsions may develop to over-value the currency in relation to the competitive strength of domestic industries. In a manner of cumulative causation, the longer a national currency plays its role as the international reserve currency, the more deeply entrenched becomes the interests of the international financial sector to make such compulsions stronger. The longer-run untenability of trying to maintain the reserve currency status and simultaneously using it as the soft option in economic management may show itself ultimately in a growing divergence of interests between international finance and domestic industry.

Table 1

-U.S. international transactions, 1946-87

[Millions of dollars; quarterly data seasonally adjusted, except as noted. Credits (+), debits (-)]

Year or quarter	Merchandise ¹		Investment income ²			Net military transactions	Net travel and transportation receipts	Other services, net ³	Balance on goods and services ⁴	Remittances, pensions, and other unilateral transfers ⁵	Balance on current account ⁶	
	Exports	Imports	Net	Receipts	Payments							Net
1946	11,764	-5,067	6,697	772	-212	560	-493	733	310	7,807	-2,922	4,885
1947	16,097	-5,973	10,124	1,102	-245	857	-455	946	145	11,617	-2,625	8,992
1948	13,265	-7,557	5,708	1,921	-437	1,484	-799	374	175	6,942	-4,525	2,417
1949	12,213	-6,874	5,339	1,831	-476	1,355	-621	230	208	6,511	-5,538	873
1950	10,203	-9,081	1,122	2,068	-559	1,509	-576	120	242	2,177	-4,017	-1,840
1951	14,243	-11,176	3,067	2,633	-583	2,650	-1,270	298	254	4,399	-3,515	884
1952	13,449	-10,838	2,611	2,751	-555	2,196	-2,054	83	309	3,145	-2,531	614
1953	12,412	-10,975	1,437	2,736	-624	2,112	-2,423	-238	307	1,195	-2,481	-1,286
1954	12,929	-10,353	2,576	2,929	-582	2,347	-2,460	269	305	2,499	-2,280	219
1955	14,424	-11,527	2,897	3,406	-676	2,730	-2,701	-297	299	2,928	-2,498	430
1956	17,556	-12,803	4,753	3,837	-725	3,102	-2,788	-361	447	5,153	-2,423	2,730
1957	19,562	-13,291	6,271	4,180	-796	3,384	-2,841	-189	482	7,107	-2,345	4,762
1958	16,414	-12,952	3,462	3,790	-825	2,965	-3,135	-633	486	3,145	-2,361	784
1959	16,458	-15,310	1,148	4,132	-1,061	3,071	-2,805	-821	573	1,166	-2,448	-1,282
1960	19,650	-14,798	4,852	4,616	-1,237	3,379	-2,752	-964	638	5,191	-2,367	2,824
1961	20,108	-14,537	5,571	4,999	-1,245	3,754	-2,596	-978	732	6,484	-2,652	3,832
1962	20,781	-16,260	4,521	5,618	-1,324	4,294	-2,449	-1,152	911	6,127	-2,740	3,387
1963	22,272	-17,048	5,224	6,157	-1,561	4,596	-2,304	-1,309	1,037	7,244	-2,831	4,414
1964	25,501	-18,700	6,801	6,824	-1,784	5,040	-2,133	-1,146	1,161	9,724	-2,901	6,823
1965	26,461	-21,510	4,951	7,437	-2,088	5,349	-2,122	-1,280	1,480	8,378	-2,948	5,431
1966	29,310	-25,493	3,817	7,528	-2,481	5,047	-2,935	-1,331	1,496	6,095	-3,064	3,031
1967	30,656	-26,866	3,800	8,020	-2,747	5,273	-3,226	-1,750	1,742	5,838	-3,255	2,583
1968	33,526	-32,991	635	9,368	-3,378	5,990	-3,143	-1,548	1,759	3,693	-3,082	611
1969	36,414	-35,807	607	10,912	-4,869	6,043	-3,328	-1,763	1,564	3,524	-3,125	399
1970	42,469	-39,866	2,603	11,747	-5,516	6,231	-3,354	-2,038	2,329	5,773	-3,443	2,331
1971	43,319	-45,579	-2,260	12,707	-5,436	7,271	-2,893	-2,345	2,649	2,423	-3,856	-1,433
1972	49,381	-55,797	-6,416	14,764	-6,572	8,192	-3,420	-3,063	2,965	-1,742	-4,052	-5,795
1973	71,410	-70,499	911	21,808	-9,655	12,153	-2,070	-3,158	3,406	11,244	-4,103	7,140
1974	98,306	-103,811	-5,505	27,587	-12,084	15,503	-1,653	-3,184	4,231	9,392	-7,431	1,962
1975	107,088	-98,185	8,903	25,351	-12,564	12,787	-746	-2,812	4,853	22,984	-4,868	18,116
1976	114,745	-124,228	-9,483	29,286	-13,311	15,975	559	-2,558	5,027	9,521	-5,314	4,207
1977	120,816	-151,907	-31,091	32,179	-14,217	17,962	1,528	-3,565	5,679	-9,488	-5,023	-14,511
1978	142,054	-176,001	-33,947	42,245	-21,680	20,565	621	-3,573	6,459	-9,875	-5,552	-15,427
1979	184,473	-212,009	-27,536	64,132	-32,960	31,172	-1,778	-2,935	6,214	5,138	-6,128	-991
1980	224,269	-249,749	-25,480	72,506	-42,120	30,386	-2,237	-997	7,793	9,466	-7,593	1,873
1981	237,085	-285,063	-27,978	86,411	-52,329	34,082	-1,183	144	9,278	14,344	-7,460	6,884
1982	211,198	-247,642	-36,444	83,549	-54,883	28,666	-274	-992	9,320	278	-8,956	-8,679
1983	201,820	-268,900	-67,080	77,251	-52,376	24,875	-243	-4,227	9,908	-36,766	-9,480	-46,246
1984	219,900	-332,422	-112,522	85,910	-67,419	18,491	-1,942	-8,604	9,741	-94,835	-12,178	-107,013
1985	215,935	-338,083	-122,148	88,299	-62,901	25,398	-3,339	-10,866	9,861	-101,093	-15,301	-116,393
1986	224,361	-368,700	-144,339	88,209	-67,365	20,844	-3,662	-9,903	11,368	-125,694	-15,658	-141,352

Table 2.

International investment position of the United States at year-end, 1979-86

[Billions of dollars]

Type of investment	1979	1980	1981	1982	1983	1984	1985	1986
Net international investment position of the United States	94.5	106.3	141.1	137.0	89.6	3.6	-111.9	-263.6
U.S. assets abroad	510.6	607.1	719.8	824.9	873.9	896.1	949.4	1,067.9
U.S. official reserve assets	19.0	26.8	30.1	34.0	33.7	34.9	43.2	48.5
Gold	11.2	11.2	11.2	11.1	11.1	11.1	11.1	11.1
Special drawing rights	2.7	2.6	4.1	5.3	5.0	5.6	7.3	8.4
Reserve position in the International Monetary Fund	1.3	2.9	5.1	7.3	11.3	11.5	11.9	11.7
Foreign currencies	3.8	10.1	9.8	10.2	6.3	6.7	12.9	17.3
U.S. Government assets, other than official reserve assets	58.4	63.8	68.7	74.6	79.5	84.9	87.7	89.4
U.S. loans and other long-term assets	56.5	62.0	67.2	72.9	77.8	82.9	85.8	88.6
Repayable in dollars	54.1	59.8	65.0	70.9	76.0	80.8	84.1	87.0
Other	2.4	2.2	2.2	1.9	1.8	1.8	1.7	1.6
U.S. foreign currency holdings and U.S. short-term assets	1.9	1.7	1.5	1.7	1.7	2.0	1.8	.9
U.S. private assets	432.2	516.6	621.1	716.4	760.7	776.3	818.5	929.9
Direct investment abroad	187.9	215.4	228.3	207.8	207.2	211.5	229.7	259.9
Foreign securities	56.8	62.7	63.4	75.5	83.8	89.1	112.8	131.1
Bonds	42.0	43.5	45.8	56.7	57.7	61.8	73.0	80.2
Corporate stocks	14.8	19.2	17.6	18.8	26.1	27.3	39.8	50.9
U.S. claims on unaffiliated foreigners reported by U.S. nonbanking concerns	31.5	34.7	35.9	28.6	35.1	30.1	28.6	32.6
U.S. claims reported by U.S. banks, not included elsewhere	157.0	203.9	293.5	404.6	434.5	445.6	447.4	506.4
Foreign assets in the United States	416.1	500.8	578.7	688.0	784.3	892.5	1,061.3	1,331.5
Foreign official assets in the United States	159.9	176.1	180.4	189.1	194.5	199.2	202.5	240.8
U.S. Government securities	106.6	118.2	125.1	132.6	137.0	143.0	143.4	177.4
U.S. Treasury securities	101.7	111.3	117.0	124.9	129.7	135.5	135.7	170.7
Other	4.9	6.9	8.1	7.7	7.3	7.5	7.7	6.7
Other U.S. Government liabilities	12.7	13.4	13.0	13.6	14.2	14.8	15.6	17.4
U.S. liabilities reported by U.S. banks, not included elsewhere	30.5	30.4	26.7	25.0	25.5	26.1	26.7	27.3
Other foreign official assets	9.9	14.1	15.5	17.9	17.7	15.2	16.7	18.7
Other foreign assets in the United States	256.3	324.8	398.3	498.9	589.8	693.3	858.8	1,090.7
Direct investment in the United States	54.5	83.0	108.7	124.7	137.1	164.6	184.6	209.3
U.S. Treasury securities	14.2	16.1	18.5	25.8	33.8	58.2	83.6	96.0
U.S. securities other than U.S. Treasury securities	58.6	74.1	75.1	93.0	113.7	127.3	206.6	309.5
Corporate and other bonds	10.3	9.5	10.7	16.7	17.3	32.8	82.5	142.1
Corporate stocks	48.3	64.6	64.4	76.3	96.4	94.6	124.1	167.4
U.S. liabilities to unaffiliated foreigners reported by U.S. nonbanking concerns	18.7	30.4	30.6	27.5	26.9	31.0	29.4	26.7
U.S. liabilities reported by U.S. banks, not included elsewhere	110.3	121.1	165.4	228.0	278.3	312.2	354.5	449.2

Source: Department of Commerce, Bureau of Economic Analysis.

TABLE 3

Expenditure, Income Imbalance in the U.S. (selected years)
(as percentage of GDP)

	1960	1968	1974	1976	1978	1980	1982	1984	1985
Gross fixed capital formation	18	18.1	18.6	17.5	20.1	19.1	17.2	18.1	18.6
Net Saving	9.2	9.6	8.8	6.7	8.9	5.9	2.7	4.5	3.7
Trade Balance	0.8	0.1	0.1	-0.1	-1.2	-0.5	-0.8	-2.9	-3
Surplus on current transactions	0.6	0.2	0.5	0.5	-0.5	0.4	0	-2.4	-2.9

Source: OECD, Historical Statistics.

TABLE 4

International Reserve Position of the United States,
selected years, 1952-87
(Billion SDR)

	1952	1962	1972	1982	1984	1985	1986	1987
1. Total Reserve (Notes 1,2)	49.4	62.9	147.3	361.5	404.2	438.5	451.8	526.8
2. Reserve of the United States	24.7	17.2	12.1	29.9	33.5	38.4	39.8	35.2
3. Reserve of the U.S. as a ratio of total reserve	0.5	0.27	0.08	0.08	0.08	0.09	0.09	0.07

1 International reserves consist of monetary authorities' holding of gold (at SDR 35 per ounce), special drawing rights, reserve positions in the IMF and foreign exchange. Data exclude U.S.S.R. and, eastern Europe and Cuba (after 1960).

2 Dollars per SDR = 1.086 (1972), 1.103 (1982), 0.980 (1984), 1.098 (1985), 1.223 (1986), 1.373 (1987).

Source: IMF. International Financial Statistics.

NOTES

1. In essence this theory of adjustment goes back to David Hume's seminal essay, "On the balance of trade" (Hume, 1955) where he attacked the mercantilist case for accumulation of precious metals.
2. Formally, the beginning of the Gold Standard can be dated to 1821 when Britain guaranteed the full convertibility of its national currency into gold and, by a special decree, the Bank of England was legally required to redeem its notes into gold bars and coins.
3. If $F =$ foreign borrowing $=$ increase in monetary liabilities abroad (for the reserve currency country) the, investment, $I =$ domestic savings, $S = F$ or, $Y = (I-F)/s$ where, $S = sY$. Hence larger F would mean lower income adjustment at home.
4. The interpretation of British trade statistics, especially for the first half of the 19th century, has been controversial. Hobsbawm (1969) p.144, for instance, maintains that at no time during the 19th century did Britain have an export surplus in goods. Despite differences of opinion regarding exact magnitudes, there can hardly be any doubt that Britain's export surplus in the last quarter of the 19th century is almost entirely accounted for by invisible trade.
5. See 'Pattern of trade and development' and 'International investment today in the light of 19th century' in Nurkse (1962). This also led Nurkse to argue in the latter article that this large and sustained foreign investment programme by Britain avoided an acute "sterling shortage" by permitting sufficient growth in international liquidity in contrast to immediate post-second world war era of "dollar shortage".
6. Nurkse (1962) p.287 provides further information and discussion on this point.
7. Robinson (1954) estimates these magnitudes.
8. Minute of February 22, 1925.
9. Depreciation (capital consumption) varies between 1/3 to 1/2 (as an over-estimate), excluding residential housing and other construction. When construction is taken into account, the proportion is lower.

10. E.g. Britain's expenditure in the first world war and the U.S. expenditure on the Vietnam war at a time when the 'Great Society' programme involved rising social consumption.

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