SPECIAL
ANALYSIS

PRESIDENTIAL MEASURES ON BALANCE OF PAYMENTS CONTROLS

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This poses a puzzle. Homebuilding was strong in the late Forties and early Fifties as the nation scrambled to make up for 15 years of depressed construction—the most severe lapse in our history. Yet in spite of the evident need for more housing and substantial government assistance, demand was not strong enough to allow the industry to command as large a share of the nation's resources as it had in earlier decades.

Family incomes have grown rapidly since the mid-Fifties, not only in current dollars but also in dollars adjusted for price increases. Moreover, the rate of increase accelerated in the early Sixties. Yet even when credit market conditions were extremely favorable for homebuilding in the early and mid-Sixties, output of new homes failed to pierce the records set a decade earlier. And homebuilding dropped off after early 1964—amid complaints of overbuilding—well before booming overall economic growth appreciably began to drain resources away from this industry.

Consumer Investment in Housing

Further questions arise if one focuses on homebuilding as an avenue for personal saving. The usual measures of saving—for example, those of the Commerce Department, the Securities and Exchange Commission, and the Federal Reserve Board — include households' net investments in housing (gross home purchases minus depreciation of existing homes). For the most part, these are investments in single-family homes. The official figures do not include appreciation due to rising market values; they thus understate saving, as it is viewed by many individuals, in an inflationary environment.

The accompanying table sketches the changing character of individuals' asset acquisitions since the mid-Fifties. Investment in new housing has been exceedingly sluggish, despite the steep acceleration in growth of liquid assets—in turn reflecting the much more expansive monetary policy of the Sixties—and markedly higher acquisition rates for automobiles, home appliances, and other durables.

The relative decline in net home purchases over the past decade has been especially conspicuous relative to household saving. Total personal saving—growth in assets minus increases in debt, or the gain in households' net worth—has climbed rapidly in recent years. But consumers, who had been building up equity in single-family homes during the Fifties, appear to have been reducing their nominal equity in the Sixties. This is partly an accounting illusion: inflation in real estate values has almost certainly produced an increase in home equity during the past two years.

A Search for Solutions

Explaining the diminishing importance of homebuilding in the economy and the erosion of personal investment in new homes is more than an intellectual exercise. At stake are fundamental questions about the ability of this industry to satisfy public needs.

The temporary 1966-67 slump in homebuilding reflected the inability of the consumer and the homebuilding industry to outbid other business sectors and government for credit and for productive resources in a period of intense economic growth.

More fundamentally troublesome, however, is the sluggish growth in private demand for housing over the past decade as well as over the past 50 years and more. To some extent, this reflects demographic trends. The reduced propensity of households to invest in new homes, for example, partly reflects changes in the structure of the population in the Sixties. But, historically, even major movements in home construction have been only loosely related to demographic changes.

The heaviest drag on demand for new homes has been the sensitivity of consumers to the cost of housing—including construction costs, land prices, mortgages rates, downpayment requirements, and real estate taxes.

Over the long run, new home prices have gone up considerably faster than the general price

Household Investment, Borrowing and Saving
(Net flows, billions of dollars)

	1955-59 Average	1960-64 Average	1965	1966	1967	1968 1st Half*
Financial Assets	25	32	48	43	54	53
Liquid assets ...	11	23	34	22	46	25
Fixed income securities	5	1	3	10	−1	15
Other	9	8	10	11	9	13
Real Assets	22	22	29	28	23	31
Homes	*15*	*13*	*12*	*11*	*9*	*13*
Other	7	10	18	17	15	18
Total Assets	47	54	77	71	77	84
Borrowing	17	22	30	22	28	25
Saving	31	33	47	49	55	59
Net Investment in New Homes as a Per Cent of—						
Disposable income	5.0	3.2	2.5	2.2	1.6	2.3
Total asset accumulation ...	32	23	15	16	11	16
Saving	50	39	25	28	16	23

*Seasonally adjusted annual rates.

Note: Changes in holdings of assets exclude capital gains and losses; borrowing shown net of repayments. Acquisitions of real assets are new purchases less depreciation of the existing stock. "Other" real assets are largely autos, appliances, and home furnishings. Saving is growth of assets minus borrowing.

level. This has partly reflected escalating land costs—an unavoidable trend in light of the fixed availability of potential housing sites, the growth in population and incomes, and more extensive land use by government and business. But home construction costs have also tended to rise faster than the overall price level. For the most part, this has reflected a slower growth of productivity in this industry than in the overall economy.

Galloping Construction Costs

For the second time since World War II, construction costs have been galloping ahead of the rise in the general price level. This means that any given rate of increase in rents or in the prices of existing homes will tend to encourage less new building than a comparable rise would have induced 3-5 years ago. As yet, it is not evident that the value of the existing housing stock has been rising fast enough to lift housing starts to a 2 million annual rate.

Moreover, achievement of any given target for housing starts would be tarnished if rising rental and home-ownership costs compel consumers to downgrade their purchases and accept lower-quality housing. Historically, real residential construction has risen less than housing starts. It appears that downgrading has accelerated in the past two years. Consumers have also responded by stepping up their purchases of mobile homes—a form of residential construction which is produced outside the homebuilding industry and omitted from the usual homebuilding figures.

The recovery of housing starts in 1968 to a 1½ million annual rate, despite the fact that the net volume of mortgage lending in the first half of this year was no larger than in 1963-65, while home prices are 20-30 per cent higher, testifies to the current strength of demand. If more money becomes available for mortgage loans, starts can ascend even higher. But the experience of the early Sixties suggests that easier credit conditions, in themselves, are not likely to provide more than a relatively temporary boost to home construction. More fundamental solutions are necessary if we are to come close to the Government's 2.6 million goal.

Merton J. Peck, a member of the President's Council of Economic Advisers, pointed out recently that a 50 per cent increase in activity would "strain the resources of any sector and put pressure on its prices."

> The construction sector, however, may be especially vulnerable. Despite considerable recent technological advance, there is evidence that this industry has not achieved its rightful place in the procession of progress. . . . It is clear . . . that construction represents a potential bottleneck . . .

Efforts to meet the 2.6 million target through Government subsidies to homebuyers and renters will tend to make housing more expensive for those who are not subsidized. This, in turn, will cut into home purchases by middle- and upper-income groups.

A subsequent article will delve further into the demographic outlook, the problem of rising home costs, and some of the proposed solutions—including the innovations embodied in the Housing Act of 1968. There is a noteworthy agreement among Government officials and a large segment of the homebuilding industry that business as usual is not enough.

The Search for Protection of International Reserves

The search by governments and central banks for ways to protect their countries' international reserves is one international monetary fact of life that has once again been much in evidence in recent months. The opportunity to add to official monetary gold stocks out of the substantial amounts sold by France and the International Monetary Fund has been seized by a strikingly large number of countries. Ample use is also being made by governments and central banks of the various arrangements under which they can secure, to varying degrees, protection for their foreign exchange assets.

At the IMF meetings last month in Washington, pleas mounted for an early ratification by governments of the new international monetary facility in the form of Special Drawing Rights. The value of SDRs is guaranteed "in terms of a weight of gold"—a feature that the Fund's Managing Director, M. Pierre-Paul Schweitzer, emphasized in the following context:

> While special drawing rights will, I expect, eventually become a major component of international reserves, it is important at this stage to do nothing to undermine, and to do whatever is possible to strengthen, the traditional reserve components. The new facility is intended, when the need arises, to supplement, not to supplant, gold and foreign exchange. This is no more than common sense. Gold is a traditional means of international settlement and a point of reference for the values of national currencies. The value of special drawing rights is guaranteed in terms of a weight of gold. More than one half of all monetary reserves consists of gold, and it continues to be the basic element in the world monetary system.

The Buildup of Gold Reserves

Against this background of practical realism regarding gold, it is of interest to review the

changes in the monetary gold stocks of governments and central banks over the six months ended in September. In the wake of the disturbances in its economy and its balance of payments, France not only used the dollars it had in its reserves or was able to secure from the IMF and central banks of other countries, but also sold gold—$1,069 million from June through September. The IMF, in order to accommodate the British and French drawings last June, not only used its own resources and borrowed currencies but also raised $547 million by selling gold to thirteen countries other than the United States.

The Federal Republic of Germany, Italy and other Continental countries have added appreciable amounts to their already substantial gold reserves. Although the United States had acquired a sizable part of the $1.1 billion of gold sold by France since June, its reserve has shown a rather moderate rise.

The redistribution of gold in the recent past stands out clearly from the chart, along with changes in official foreign exchange holdings, for the most part U.S. dollars. France has disposed of part of the gold reserve it built up during 1959-67 largely through purchases from the United States; it had sold large amounts to the United States during the prolonged period of its balance-of-payments deficits from 1935 to 1958. Even so, it has the third largest gold reserve in the world. Germany and Italy, which had little gold before World War II, are now the second and the fourth largest gold-holding countries; Switzerland is the fifth. The United States is, of course, the first.

The rise in South Africa's gold reserve has come from new output, which the central bank purchases, and, as needed, sells. During April-September, its reserve showed an increase of $327 million; South African output during this period may be estimated at $550 million.

For the world as a whole, official gold stocks have increased since the end of March—in sharp contrast with the $3 billion outflows into private uses and holdings during the gold crisis in late 1967 and early 1968. During the second quarter of 1968, the rise amounted to $290 million—$33 million more than could be accounted for by additions to the reserves of South Africa and Australia; and, judging from incomplete data, total stocks rose further during the third quarter. Thus, the world's monetary gold has not, in effect, been frozen at the $40 billion level of last March when the Washington conference of seven countries expressed the feeling that it was no longer necessary for central banks to buy gold from the private market.

Blending Gold, Dollars and SDRs

Some students of international finance have of late expressed the thought that an international monetary system containing more than one kind of international asset would be difficult to operate. So long as there are several assets in which monetary authorities can keep reserves—gold, dollars, reserve positions in the IMF and, hopefully next year, SDRs—and so long as the composition may be freely changed by shifting from one kind to another, instability may result. The SDRs may help meet the need for more reserves, but they cannot deal with matters of confidence.

Rules have been devised to prevent switches from SDRs into gold; but switches from dollars to gold have not been banned. To prevent conversions of dollars into gold, schemes have been suggested to blend gold, dollars and SDRs in fixed proportions; to take dollars out of official reserves by having them turned into deposits on the books of an international institution; or to crown SDRs as the only reserve asset.

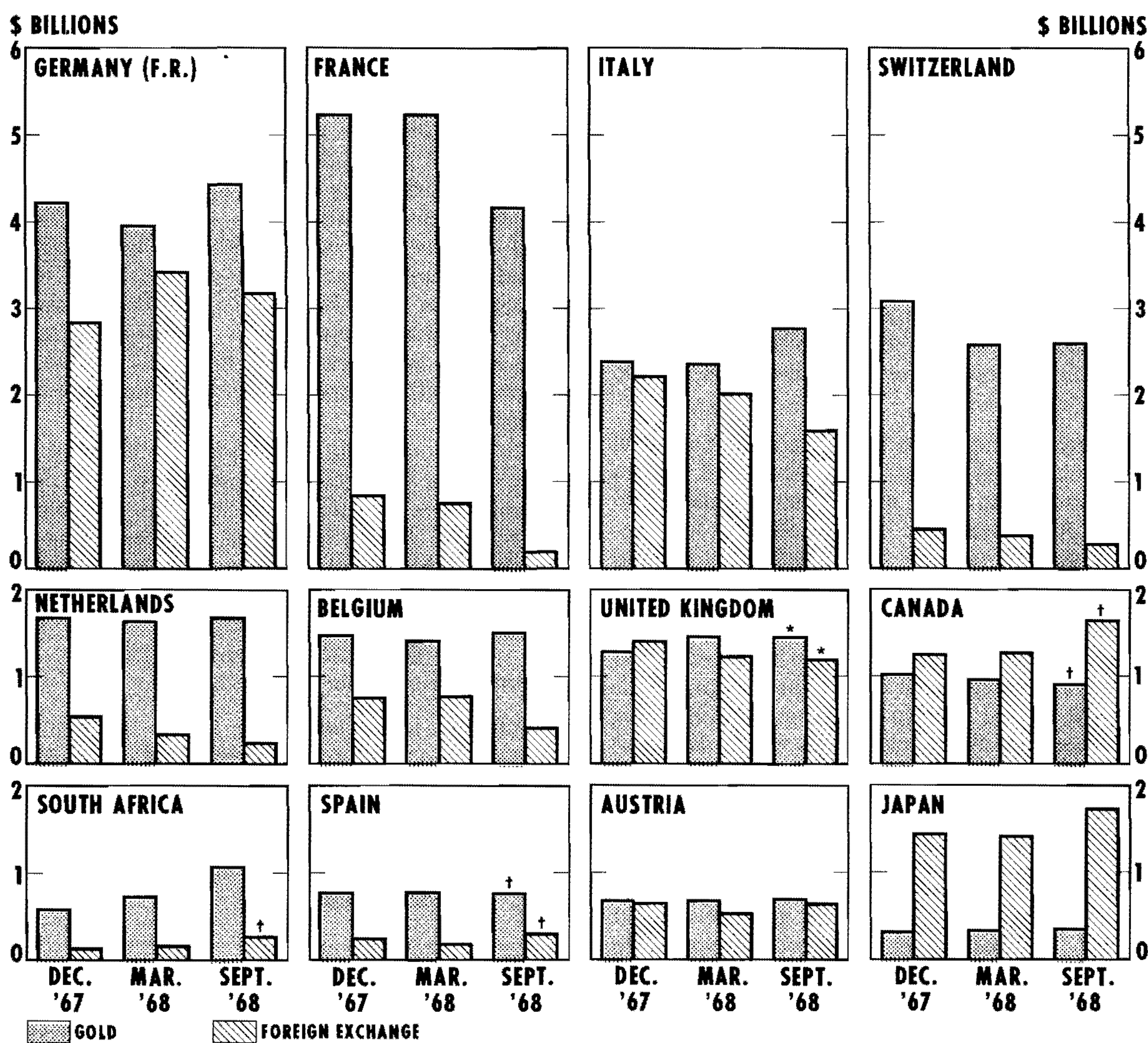
Schemes like these have found little support outside narrow circles. Historically, it may be recalled, governments and central banks chose freely to hold sterling or dollars in monetary reserves because they found it safe, profitable and convenient to do so, and because they were confident that they could at any time,

Changes in Monetary Gold Stocks of Governments and Central Banks

	Millions of dollars		Percentage of gold in total reserves*	
	Oct. '67-Mar. '68	Apr.-Sept. '68	Mar. '68	Sept. '68
Losses in Apr.-Sept. '68:				
France	$ 1	$ −1,069	87%	95%
Canada	−123	−113	43	34
United Kingdom	−338	−19†	55	55†
Intl. Mon. Fund	32	−415	...	...
Gains in Apr.-Sept. '68:				
Germany (Fed. Rep.)	−312	484	54	58
Italy	− 25	408	54	63
Belgium	− 96	106	64	78
Netherlands	− 77	43	82	88
Switzerland	−238	23	87	90
United States	−2,374	52	80	78
South Africa	253	327	81	79‡
Ireland	13	45	9	24‡
Australia	5	25	19	22
Other developed countries§	52	191‡	...	...
Middle East	220	115‡	...	...
All other countries	265	75‡	...	...

* Total gold and foreign exchange reserves. † Through June. ‡ Through August. § Mainly Austria, Denmark, Greece, Norway, Portugal, Sweden and Yugoslavia. ... Not applicable.

Note: Adapted from International Monetary Fund *International Financial Statistics.*



Gold and Foreign Exchange Reserves of Governments and Central Banks

* June. † August.

without having to give any explanations, shift from one currency to another or into gold. Today, they are not ready to relinquish this freedom of choice. They have retained the right of "opting out" of SDRs.

The preference for gold—documented in that part of the table showing the proportion of gold to total reserves—basically reflects deeply anchored views that there are times and circumstances where no other money will do because gold alone is universally acceptable as the means of payment of last resort. These views rest in part on the thought that gold is beyond the control of any one nation—especially as it is redistributed today, with the United States holding only slightly more than a quarter of the world's monetary stock. They also reflect the desire to protect reserves against the hazards of depreciation.

As the Governor of the Bank of England, Sir Leslie O'Brien, remarked on October 17:

> . . . I find the tendency to attack the role of gold in the system somewhat ironic, when it is not gold which is the root cause of the present uneasiness but doubts about the alternative reserve assets. While admitting all the imperfections of gold as a monetary asset, the enthusiasm for getting rid of it owes much to the fact that in this inflationary age currencies cannot stand comparison with it. . . . I suggest . . . that in this necessarily long process [leading to an international monetary system less dependent on gold and national currencies] we concentrate on containing the role of the alternatives first and leave to the last any discarding of gold . . .

The Maze of Gold and Exchange Guarantees

To protect the claims of governments and central banks on international financial institutions and the value of official foreign exchange holdings, use is made of a great variety of gold and exchange clauses. All accounts of the Bank for International Settlements are kept in gold Swiss

francs. The obligations of a country to the IMF in the event that the par value of its currency is reduced are governed by a maintenance-of-gold-value clause. The SDRs are to be guaranteed in terms of a weight of gold. The European Monetary Agreement provides for yet another form of guarantee; this protected the participating central banks at the time of the sterling devaluation a year ago.

Credits arranged to help stabilize foreign exchange rates—such as the large British borrowings from governments and central banks—contain exchange clauses. Under arrangements concluded last month, the bulk of sterling-area countries' balances held in sterling carry a dollar guarantee; on their part, the countries have undertaken to keep a guaranteed minimum proportion of their reserves in sterling.

The swap network of the Federal Reserve system, dating back to the early Sixties and comprising today nearly $10 billion of reciprocal credit lines with fourteen central banks and the BIS, offers exchange protection for the lending banks. They are to be repaid at a constant value in their own currencies and are thus protected against an adjustment in the dollar exchange rate. The protection is, of course, reciprocal. The level of drawings reached $1.8 billion at the end of 1967; most commitments were to the central banks of Italy, Germany and Switzerland and to the Bank for International Settlements. Subsequently, reversals in the flows of funds, together with a U.S. drawing on the IMF and sales of U.S. Treasury securities denominated in foreign currencies, enabled the Federal Reserve to reduce these commitments and, in mid-July, to liquidate them entirely.

Maturing commitments under swap transactions are, as noted, often consolidated over a longer period by placings of U.S. Treasury securities denominated in the lenders' currencies —German marks, Italian lire, Swiss francs, etc. These placings are also used to absorb dollar holdings in excess of the needs of the central banks to which the bonds are sold, or simply to acquire foreign currencies for intervention in the foreign exchange markets. A total of $2 billion of such Treasury securities was outstanding on September 30, with Germany, Switzerland and Italy by far the principal holders.

As a result of these various arrangements, the monetary authorities of Italy and Switzerland hold something like one half of their total foreign exchange reserves in forms that offer protection of one kind or another. The German Federal Bank holds about two fifths of its international assets other than gold in protected forms.

The Real Protection

Those responsible for administering their country's international monetary reserves seek, understandably and legitimately, to protect them against depreciation. For the buildup of international reserves—whether gold, dollars, IMF positions or SDRs—involves a surrender by a nation of present goods, services and capital assets for claims on the resources of other countries in an indefinite future—for periods short or long, or even "for good."

The protection that gold offers rests on merits in which most of the world, rightly or wrongly, still firmly believes. Exchange clauses offer protection against devaluation of individual currencies. In the IMF, as is well known, the obligations of a country, in the event that its currency is devalued, are governed by a maintenance-of-gold-value clause. A clause in the charter also states that the same provision "shall apply to a uniform proportionate change in the par value of the currencies of all members, unless at the time when such a change is proposed the Fund decides otherwise." Evidently, the language providing for the maintenance of gold value foresees, at the same time, a potential exception. The SDRs are, however, to be endowed with an absolute maintenance - of - gold - value clause; it could not be rescinded in the event of a uniform change in the price of gold.

Gold and dollar clauses are matters of great importance to countries that have incurred guaranteed debts. Britain's gold-claused debts are far larger than its gold stock; its dollar-claused debts are also sizable. Such countries cannot devalue without having to provide, in repaying the debts, greater amounts of goods, services and capital assets than anticipated at the time the debts were incurred. These considerations awaken some of the unhappy memories of the 1930s when gold clauses were abrogated in the United States and, at least in private contracts, in foreign countries as well. The crucial point is that the gold- or exchange-claused debts that governments and central banks have incurred to international institutions and to other governments and central banks are much larger today than in the 1930s.

Maintenance-of-gold-value clauses and foreign exchange guarantees are a redundant and useless appendage so long as nations preserve economic health, fiscal responsibility and monetary sobriety. But an international monetary system resting on national currencies that are unable to resist inflation could not be rescued even with the most elaborate of gold and foreign exchange guarantees.

November 1968

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