Export Credit
and
Government External Monetary Debt

IS IT ALL REALLY NECESSARY?

by

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based on statistical research by

FREDERICK W. TOOBY

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FOREWORD

I hope this paper will be widely read and that its conclusions will be heeded.

The financial forces which oblige the Government to borrow overseas have always been shrouded in obscurity, and the obscurity has been deepened by official explanations which confuse the public by referring to the "Balance of Trade," the "Balance of Payments," the "Basic Balance," and the "Current Balance."

Out of all this there has emerged a widely held belief that if the Government is obliged to borrow overseas it means that Britain is in financial difficulties, but if Government overseas debt is repaid that Britain is financially sound.

It is important that our own self-confidence should be restored by appreciating that the overall external financial position of Britain is sound, and that confidence in Sterling should be restored by extinguishing Government overseas debt.

Patrick de Laszlo has made a brilliantly clear analysis of this complex matter and presented it in such simple language that it is easy to read and easy to understand.

He has illuminated the subject so that the relative importance of each factor can be properly assessed, and reveals that loans to developing countries and export trade credits are the main causes of the Government's overseas indebtedness.

Practical suggestions are made for ridding the Government of this incubus.

It is not to be expected that all the arguments in this paper will be accepted without dispute, but it will have performed a valuable service if it causes thought to penetrate the shell of dogma which at present encrusts important problems and prevents a freer development of our economy.

February 1971 President

Patrick de Laszo was educated at Lancing and Balliol, College Oxford, where he took an honours degree in Modern Greats and a B. Litt. in Economics.

His original intention was to teach economics at the University but he had criticised his own teachers for their total lack of practical experience of commerce so he felt he ought to spend some years in business away from University.

As things turned out he was obliged by circumstances to learn practical engineering and became involved in the manufacture of electronic components and electronic equipment. His remarkable commercial success in this field prevented him from returning to the University but he always tried to keep in contact with the latest developments in economic thinking.

Since 1958 he has been Chairman of the Economic Research Council which is dedicated to promoting amongst the public a greater understanding of economics with particular reference to monetary practice.

Frederick W. Tooby was educated at Dartford Grammar School and then practised as a professional accountant in London and later in the Far East.

During the war he was posted to the staff of the Allied Commission.

After the enemy had been driven out of Italy the country was in ruins and there was an almost total breakdown in the supply of food and raw materials. Mr. Tooby was entrusted with preparing a detailed study of the food, fuel, and raw material needs of the country which were then supplied through U.N.R.R.A. He was transferred to the British Embassy staff in Rome in 1946.

Mr. Tooby later became a senior member of the U.N. Secretariat primarily engaged on detailed studies of the social and economic needs of the tropical African countries—in particular the Congo.

His great experience of preparing international aid programmes led him to take special interest in the methods which were being developed in the 1950s of presenting in statistical form both national accounts and national requirements of raw materials and food.

Since his return to England in 1965 he has made a special study of the British national accounts statistics.

The origin of this study

The first paper in this series entitled "THE GREAT TURN-AROUND IN BRITAIN'S FINANCIAL AFFAIRS" (published by the Economic Research Council July, 1970) challenged the claim made by the outgoing Government that a balance of payments "basic surplus" of £606 million during the year 1970—in contrast to a "basic deficit" of £744 million in 1964—was evidence that Government economic policy during 5½ years had been successful and had achieved "a great turnaround"—or improvement—in the financial affairs of Britain as a result of which the British economy "was now one of the strongest in the world".

We dealt with a number of arguments in detail but, above all, we drew attention to the astonishing deterioration in the external financial position of the Government during the period and made the point that since the financial strength of the country, and the stability of Sterling, is to a large extent gauged by the external financial reserves of the Government it was quite unrealistic to claim that the management of the economy had been successful because:

At the beginning of the period—October 1964—Government Overseas reserves exceeded monetary liabilities by £2,164 million.

At the end of the 5½ years—March 1970—these reserves had been dissipated. The dollar portfolio had been sold for £520 million and **the Government was £2,400 million in debt overseas.** However, it was not clear from the statistics then available why the Government overseas debt was so large.

TABLE A

OFFICIAL (GOVERNMENT) EXTERNAL MONETARY RESERVES AND LIABILITIES

£ million

At end of	Gold and Currency Reserve	Second Line* Reserves	**Official short and medium term overseas debt**	Balance of current assets and liabilities
Dec. 1962	1,002	1,231	0	+2,233
Dec. 1963	949	1,231	0	+2,180
Dec. 1964	827	957	573	+1,211
Dec. 1965	1,073	466	1,172	+ 367
Dec. 1966	1,107	385	1,481	+ 11
Dec. 1967	1,123	594	2,067	- 350
Dec. 1968	**1,009**	**68**	**3,363**	**-2,286**
Dec. 1969	1,053	83	2,664	-1,528
Sept. 1970	**1,111**	**286**	**1,611**	**- 214**

***Note**

The second line reserves are:

(a) Unused balance of I.M.F. drawing right.

(b) Government's dollar portfolio.

The reason for analysing the factors which push the Government into overseas debt

Table A shows that in 1963 there was no Government overseas borrowing. By 1968 Government overseas borrowing had reached £3,363 million and, though it subsequently declined, Government overseas debt still stood at £1,611 million in September, 1970, while our "gold and foreign currency reserve" only amounted to £1,111 million.

Such massive Government overseas borrowing, when compared with our meagre "gold and currency reserve", gives the impression that the international finances of Britain are balanced on a knife edge and a number of economic pundits have come to the conclusion, at which they have hinted or have openly announced, that the only solution is a further devaluation unless we can earn a regular annual surplus on our "Balance of Trade" with which to "pay off" Government overseas debt, which we contend is impossible in present circumstances.

The first object of this paper is to show that this conclusion is mistaken and results from focusing too much attention in Government overseas debt and "on our gold and foreign currency reserve" instead of on the Overall External Position of the nation which has all along been sound—by this we mean that, if Government and Private Sector international assets and liabilities are taken together, it is clear that the Nation is not only solvent but that we have been steadily improving our position.

The second object is to explain why Government overseas debt is still so large. It is a serious matter, so the reasons for it should be more widely understood.

Lord George-Brown claimed that the trouble was all due to a Balance of Payments deficit inherited from the Tories.

This had all the charm of a traditional myth complete with a wicked ogre.

Mr. Wilson and Mr. Callaghan insisted that Government overseas borrowing was necessary to meet a chronic deficit in our Balance of Trade which they felt obliged to remedy by driving the Private Sector to increase exports, and by imposing fierce restrictions on home consumption with the object of reducing imports and freeing British goods for export. This had the agreeable sound of an ever-watchful Big Brother chiding the Private Sector for selfishly sitting on its backside and not bothering to export and it seemed to be justified by the regular publication of unfavourable overseas trade figures.

Mr. Callaghan also made great play with the charge that the "Gnomes of Zurich" manipulate vast sums of "hot money" which they had suddenly withdrawn from the British banking system for selfish and perhaps political reasons thereby making it necessary for the Government to borrow overseas to meet the outflow. This idea was very popular with the Press because it had the excitement of villainy.

Finally, Lord Balogh, in his maiden speech in the House of Lords, blamed the Private Sector for "a tendency to generate overseas investment far beyond our capacity to sustain . . ." which he alleged had contributed heavily to the deficit on our balance of payments which the Government had been obliged to meet by borrowing overseas. This sounded like irresponsible anti-social behaviour by Big Business uncovered by the vigilant Professor.

We will examine each of these explanations which, it should be noted, all blame the Private Sector for the balance of payments deficit. We will show that the balance of payments position inherited from the Tories had nothing to do with the matter but that each of the other factors did for a time lead to an "outflow" of money though at other times it contributed an "inflow" of money. However, at no time did

any one of these factors by itself, or indeed all of them taken together, explain the need for such heavy Government borrowing.

What is even more important is that today none of these factors play any significant part in explaining why the Government is still £1,611 million in debt overseas.

Finally, we make the point that since Government overseas debt inevitably creates an unfavourable impression; spreads gloom; and undermines confidence in the stability of Sterling it should be avoided and that this could easily be done by a few changes in Government financial strategy.

Statistical sources

This study of the problem has been made possible by the latest report on the Balance of Payments by the Central Statistical Office (the Pink Book of September 1970) which introduced some significant changes both in the analysis and in the form of presentation.

The principal effect of these changes is to give less weight to the "Basic Balance" which is the simple balance of receipts and payments on "current and long term capital" transaction and give more weight to "Official financing" which means the extent to which the Government has drawn on the "gold and currency reserve" or borrowed overseas. It also gives more detailed information about the Overseas Assets and Liabilities of the nation as a whole—in other words about our National Overseas Balance Sheet.

All statistics are extracted from: The "United Kingdom Balance of Payments" (Pink Book); The "National Income and Expenditure" (Blue Book); "Monthly Digest of Statistics". All published by the Central Statistical Office, and the Bank of England Quarterly Bulletins.

Foreign assets and liabilities of the nation

Table B shows that in spite of the fact that the Overseas **liabilities of the Government** increased by £2,305 million in the seven years the net overseas **assets of the nation** as a whole increased by £1,175 million because the net assets of the Private Sector increased by £3,480 million.

From this it is clear that the external financial position of the nation as a whole is not only sound but has steadily improved as a result of the overseas transactions of the Private Sector.

It seems a pity that in the monthly assessment of our economic situation the Treasury Digest fails to draw attention to these facts. The steady increase in the external assets of the Nation as a whole is neglected but Government external debt, which is only a component of our Total external liabilities, is emphasised—at the same time undue prominence is given to our "gold and currency reserve" though this again is only a component of the external assets of the nation as a whole.

Since the Treasury focuses so much attention on Government overseas debt which stood at £1,611 million on 30th September, 1970, and on our "gold and currency reserve" which stood at only £1,113 million, it is not surprising that the British and foreign Press should conclude that our external financial position is precarious.

We hope that more emphasis will in future be given to the overall position which is that our external assets far exceed our external liabilities and that since this has been steadily improving there is nothing precarious about our external financial situation save that Government overseas debt causes anxiety.

Indeed, we think it would be in the national interest if constant publication of small changes in the "gold and foreign currency reserve" were abandoned because it gives

TABLE B

IDENTIFIED EXTERNAL ASSETS AND LIABILITIES OF THE U.K.

at end of year

	£ million 1962	1969	Net change in 7 years
Private Sector			
Assets	10,295	28,845	
Liabilities	6,030	21,100	
Net balance	+4,265	+7,745	+3,480
Public Sector			
Assets	2,250	2,285	
Liabilities	4,995	7,335	
Net balance	-2,745	-5,050	-2,305
Net Totals			
Assets	12,545	31,130	
Liabilities	11,025	28,435	
Net balance of the Nation as a whole	+1,520	+2,695	+1,175

Source: Bank of England Quarterly Bulletin, September 1970.

the impression that this figure is vitally important whereas it is of little significance by itself because the Authorities deliberately keep the gold and foreign currency reserve approximately constant. (See Table A, page 2.)

Thus, if there is an outflow of currency which reduces the gold and currency reserve at the Bank of England, the reserve is promptly restored by Government overseas borrowing and if there is a substantial inflow of foreign currency a small portion may be used to "top-up" our gold and currency reserve but the bulk of it is applied to reducing Government overseas debt—so publication of the "gold and currency reserve" by itself is now meaningless and could well be abandoned.

The balance of payments deficit "inherited from the Tories" made it necessary for the Labour Government to borrow overseas

This theory was seriously advanced so it must be disposed of by showing why it was completely without foundation. We will repeat the substance of what we said in our first paper.

No one can spend more than his income without reducing his savings or borrowing. The balance of income and expenditure in any period must be exactly counter-balanced by a corresponding change in "assets" and "liabilities". This is the basic principle of all accounting.

This principle, in a slightly different form, is also the basis of our National accounts. Changes in our "Current balance" (our external Trading account) are counter-balanced by an equivalent change in the external Assets/Liabilities of the nation as a whole.

Changes in our "Basic balance" (our external Trading and long term Investing account) are counter-balanced by an equivalent change in external Monetary Assets/Liabilities, described as Monetary Movements.

In both cases any change in the value of Assets, which does not arise from a change in the "Current" or the "Basic" balance, is automatically offset by an equivalent change in Liabilities, so the balance sheet remains in balance.

Therefore a "basic deficit" in the "balance of payments" must **at the time it was incurred** have been financed either by reducing external assets (drawing upon our "gold and currency reserve" or by selling overseas assets) or else by increasing the external liabilities of the nation (borrowing).

From this it will be evident that any "basic deficit" incurred during the 12¾ years which preceded 1964 must at the time have been financed by reducing our overseas assets or by increasing our overseas liabilities. In brief, a Basic Deficit must be financed at the time it is incurred—it cannot be financed by subsequent borrowing.

TABLE C

"BASIC BALANCE" 1960-1970

	£ million
Dec. 1960	-457
Dec. 1961	+ 64
Dec. 1962	+ 14
Dec. 1963	- 35
Dec. 1964	-749
Dec. 1965	-274
Dec. 1966	- 63
Dec. 1967	-451
Dec. 1968	**-422**
Dec. 1969	+385
Sept. 1970	**+291**

In **Table C** we set out the Basic Balances since 1960 (the balance of Current and long term Capital transactions).

However we suggest that it is dangerous to draw conclusions from the "basic balance", which is merely the balance of the British Trading and Investing transactions, taken in isolation because Britain also plays such a very large part as an International Banker. For these reasons we welcome the fact that in the 1970 Pink Book the Authorities allowed the Basic Balance to recede into the background.

TABLE D

12¾ YEARS JAN. 1952/SEPT. 1964

OUTFLOW		£ million	
Net INFLOW all Private Sector transactions (other than Banking)		+3,404	
Government overseas spending		-3,926	
"Basic deficit"		- 522	
Subscription to I.M.F.		- 232	
TOTAL NET OUTFLOW		- 754	
INFLOW			
Net INFLOW of foreign short-term funds (including Banking)		+ 597	
Miscellaneous capital movements		+ 47	
Receipts unidentified ("balancing item")		+ 763	
TOTAL NET INFLOW		+1,407	
SURPLUS FOR PERIOD (Excess of INFLOW over OUTFLOW)			+ 653
Which was applied to:			
Extinguishing Government overseas debt		562	-653
Adding to Gold and Currency reserve		91	

(For fuller detail see Paper No. 1)

Tables D and E summarise the monetary movements during the two periods.

During the 12¾ years January 1952/September 1964 there was a Basic Deficit of £522 million and in addition the U.K. increased its subscription to the I.M.F. by £232 million. However these two "outflows" were more than covered by the "inflow" of funds so that at the end of the period there

TABLE E

5¼ YEARS OCT. 1964/DEC. 1969

OUTFLOW		£ million	
Net INFLOW all Private Sector transactions (other than Banking)		+2,799	
Government overseas spending		-3,853	
"Basic deficit"		-1,054	
Net OUTFLOW of foreign short-term funds (including Bnking)		-1,201	
Subscription to I.M.F.		- 175	
Loss incurred at devaluation		- 356	
TOTAL OUTFLOW		-2,786	
INFLOW			
Miscellaneous capital movements		+ 62	
Receipts unidentified ("balancing item")		+ 202	
TOTAL NET INFLOW		+ 264	
DEFICIT FOR PERIOD (Excess of OUTFLOW over INFLOW)			**-2,522**
The DEFICIT was financed by:			
Sale of portfolio of dollar securities	520		
Government overseas borrowing	**2,017**		
	2,537		
Less transfer of gold and currency reserve	15		+2,522

(For fuller detail see Paper No. 1)

was an overall financial surplus—or favourable balance—of £653 million. Therefore no deficit was inherited by the Labour Government.

In contrast, during the 5¼ years October 1964/December 1969, there was a Basic Deficit of £1,064 million as well as other heavy "outflows" which together far exceeded the "inflow" of funds during the period. This resulted in an overall financial deficit—or unfavourable balance—for the period of £2,522 million which the Government was obliged to finance by selling the dollar portfolio for £520 million and by borrowing £2,017 million overseas.

"The disturbing import/export gap"

Immediately after the last Government came to office in 1964 it started issuing shock reports about the import/export gap which the Government claimed was so great that it could not be allowed to continue because it would lead to prodigious overseas borrowing. These statements were supported by quoting the monthly balance of our "visible" Import/Export trade (our overseas trade in "goods" alone).

Table F sets out the Private Sector overseas trade both in "goods" and "services" January 1963/September 1970 annually and cumulatively.

This table shows that the "visible" trade of the Private Sector (import and export of goods) was consistently unfavourable, as it has always been for the past 175 years. However, the unfavourable "visible" balance was offset by Private Sector "invisible" earnings which were at all times favourable. If "visible" and "invisible" trade is added together it will be seen that during the period there was an unfavourable balance in some years and a favourable balance in other years but that over the period the Private Sector trade in Goods and Services was in equilibrium as it always has been for the past 175 years at least.

The cumulative figures show that an unfavourable Balance of Trade in Goods and Services in 1964, which got worse until 1968, was completely extinguished by 1970.

If the Cumulative figures are compared with outstanding Government overseas debt it will be clear that the Import/Export gap in Goods and Services during the period only played a small part in making it necessary for the Government to borrow overseas. By September 1970 the cumulative balance of trade (visible and invisible) was in our favour so it played no part at all in the outstanding Government overseas debt at that date.

TABLE F

THE IMPORT/EXPORT TRADE BALANCE COMPARED TO GOVERNMENT OVERSEAS DEBT

		Visible Balance Goods	Invisible Balance Services	Balance Goods and Services
Year to March 1963		- 80	+184	+104
December	64	-519	+161	-358
	65	-237	+165	- 72
	66	- 73	+206	+133
	67	-552	+336	-216
	68	**-643**	**+469**	**-174**
	69	-141	+564	+423
September	**70**	**-71**	**+413**	**+342**

		Cumulative Balance Goods and Services	Outstanding Government Overseas Monetary Debt
Year to March 1963		+104	Nil
December	64	-254	573
	65	-326	1,172
	66	-193	1,481
	67	-409	2,067
	68	**-583**	**3,363**
	69	-160	2,664
September	**70**	**+182**	**1,611**

The withdrawal of "hot money" from London

During the later part of 1964 and the greater part of 1965 there was lively discussion in the Press, inspired by official statements, about the withdrawal of "hot money" from London by the "Gnomes of Zurich".

This "hot money" is nothing more than cash deposited by foreigners for short periods with the U.K. banking system because British banks are organised to use foreign short term deposits to advantage and so are able to pay day to day interest on it. It is obviously attractive for the foreigner to deposit spare cash with a bank—receive day to day interest—and be able to withdraw it at call.

It should be noted that when this money flows into London Governments tend to take credit for the improvement in our balance of payments but, when it is withdrawn from London, it is scathingly referred to as "hot money" with the implication that it is somehow immoral in origin.

In reality there is nothing either "moral" or "immoral" about this money. British banks can find a use for it and foreigners find London a convenient temporary home for surplus funds. There are not many alternatives open to foreign depositors because few countries have an international banking system so well developed as the British banking system and therefore in a position to use short term foreign deposits and pay interest on them.

As a rule, America is the only other country which provides an equally convenient home for short term foreign deposits because the American banking system is also able to use short term money and pay day to day interest on it. So short term money tends to flow either towards New York or towards London depending on the interest offered and foreign assessment of the relative stability of the $ and the £.

Until the publication of the 1970 Pink Book it was difficult to discover the actual volume of money which had moved in and out of England in the form of foreign short term deposits

TABLE G

THE HOT MONEY BALANCE COMPARED TO GOVERNMENT OVERSEAS DEBT

	"Hot Money" Balance of Foreign Deposits in U.K. Banks £ million	Outstanding Government Overseas Monetary Debt £ million
	Annual Balances	
Dec. 1964	+ 50	
65	- 92	
66	-123	
67	-216	
68	**-377**	
69	+208	
Sept. 70	**+501**	
Net total (Jan 64/Sept. 70)	- 49	
	Cumulative Balances from Jan. 1, 1964	
Dec. 1964	+ 50	573
65	- 42	1,172
66	-165	1,481
67	-381	2,067
68	**-758**	**3,363**
69	-550	2,664
Sept. 70	**- 49**	**1,611**

but the figures are now available and are set out in **Table G.** It is surprising to find that, in spite of all the talk, short term deposits actually increased during 1964 but diminished during 1965, and right up to 1968 the sums withdrawn were nothing like so great as the public was led to believe.

Since the beginning of 1969 short term deposits have been steadily flowing back into London.

The cumulative figures show that the withdrawal of "hot money" had nothing to do with Government borrowing in 1964 though it was a contributory factor during several succeeding years. However by September 1970 the balance on this account was only £-49 million while Government overseas debt still stood at £1,611 million.

Excessive private sector long term overseas investment

Lord Balogh, in his maiden speech in the House of Lords in July 1968, was concerned by the Import/Export gap but he also advanced the theory that a large part of our Balance of Payments trouble was due to the "tendency of our financial system to generate overseas investment far beyond our capacity to sustain . . .".

Government policy from 1964 onwards was to reduce imports; increase exports; and restrain Private overseas spending by restrictions on travel etc. In addition, probably as a result of Lord Balogh's advice, the Government restricted Private Sector overseas investment.

Few people are aware that the official figures for Private Sector overseas investment include unremitted profits of British overseas companies. This is correct accounting because these profits are retained to finance the expansion of overseas companies and so they also appear on the opposite side of our overseas balance sheet as an increase in our overseas assets.

Nevertheless they are not funds withdrawn from our gold and currency reserve by the Private Sector to pay for overseas investment which might have been supposed from Lord Balogh's speech.

Table H shows that Private Sector overseas investment was very small compared to Government overseas debt and the table also shows that only in two years was there an actual cash outflow from Britain:

1964—£159 million (I.C.I./Montecatni investment)
1965—£23 million

In the circumstances it is hard to see why Private Sector overseas investment was "far beyond our capacity to sustain . . .".

Total effect of import/export gap; hot money movement; and private sector overseas investments

It is worth taking these three factors together in order to find out whether in total they made it necessary for the Government to borrow so heavily overseas.

TABLE H

BALANCE OF PRIVATE LONG-TERM OVERSEAS INVESTMENT COMPARED TO GOVERNMENT OVERSEAS DEBT

	Balance of Unremitted Profits from British owned overseas Cos. and Foreign owned British Cos. Included in the figure for Private Sector Net Foreign Investment	Private Sector Net Foreign Investment (Items 4, 5 & 6 Table 3 1970 Pink Book) £ million	Outstanding Government Overseas Monetary Debt £ million
		Annual balances	
Dec. 1964	*- 67*	-226	
65	*- 49*	- 72	
66	*- 90*	- 14	
67	*- 93*	- 35	
68	*-101*	**+ 14**	
69	*- 92*	**+ 74**	
Sept. 70		**+122**	
Nett total Jan. 64/Sept. 70		**-137**	
		Cumulative Balances from Jan. 1, 1964	
Dec. 1964	*- 67*	-226	573
65	*-116*	-298	1,172
66	*-206*	-318	1,481
67	*-299*	-347	2,067
68	*-400*	**-333**	**3,363**
69	*-492*	-259	2,664
Sept. 70		-137	**1,611**

TABLE I

TOTAL OF THE THREE FACTORS OFFICIALLY BLAMED FOR DRIVING THE GOVERNMENT INTO OVERSEAS DEBT

£ million

	Private Sector Import/Export Goods and Services	'Hot-money' Foreign-owned deposits in U.K. Banks	Private Sector Net Overseas Investments	Net Cumulative Balance of the 3 Factors	Outstanding Government Overseas Monetary Debt
	Annual Balances				
Dec. 1964	-358	+ 50	-226		
65	- 72	- 92	- 72		
66	+133	-123	- 14		
67	-216	-216	- 35		
68	**-174**	**-377**	**+ 14**		
69	+423	+208	+ 74		
Sept. 70	+342	+501	**+122**		
	Cumulative Balances from Jan. 1964				
Dec. 1964	-358	+ 50	-226	-534	573
65	-430	- 42	-298	-770	1,172
66	-297	-165	-318	-780	1,481
67	-513	-381	-347	-1,241	2,067
68	**-687**	**-758**	-333	**-1,778**	**3,363**
69	-264	-550	-259	-1,073	2,664
Sept. 70	**+ 78**	**- 49**	**-137**	**- 108**	**1,611**

The cumulative figures in **Table I** show that even in the worst year—1968—the **total** of our **import/export gap**, the **hot money** movement, and **private sector overseas investment** was only £1,778 million which was far less than Government Overseas debt (£3,336 million) and by 1970 the strain imposed by these three factors on our Balance of Payments had disappeared because the balance of our Import/Export Trade and Hot Money taken together was favourable, and the unfavourable balance of Private Sector Overseas Investment was insignificant and, as we have pointed out, was by this time comprised entirely of unremitted overseas profits. Yet Government debt still stood at £1,611 million.

Other factors which strain our Balance of Payments but are seldom officially mentioned

We have shown that official explanations of Government overseas debt were at best only half-truths and failed to explain why Government overseas debt still stood at £1,611 million in the Autumn of 1970.

Three factors which are scarcely ever mentioned were at the root of the matter.

1. Government overseas expenditure on current account.
2. Government loans to Developing Countries.
3. Export trade credits.

Since 1964 these three factors have imposed an increasing strain on our Balance of Payments. All three are directly or indirectly the result of Government action. Together they imposed a greater strain than the **Total** of the Private Sector overseas transactions which were officially blamed for the Balance of Payments trouble. Finally, by 1970, two of these three factors were alone responsible for the whole outstanding Government overseas debt.

Government overseas expenditure on current account

This is an old factor in our Balance of Payments. It has been with us for many years and has only imposed a relatively small load on the Balance of Payments but we draw attention to it because it is never mentioned in official explanations of an adverse Balance of Payments.

It is of course impossible for the civilian to judge the necessity for the Government current overseas expenditure

because it is made up of so many elements which result from our diplomatic and military obligations. However, we think it important to highlight the source from which the Government has in practice obtained the foreign currency to meet this expenditure.

We have shown that our external trade in Goods and Services appears to be self-balancing. Statistical evidence, set out later in this paper, confirms that in the long run the Balance of Trade in Goods and Services has been neither favourable nor unfavourable so it cannot be treated as a source of overseas income available to meet Government Overseas expenditure. But, fortunately, there has been a steady inflow of foreign income from **Interest, Profits,** and **Dividends** from past overseas Investment by the Private Sector and this was the only steady inflow of foreign income which could be relied upon to meet Government current overseas expenditure.

Table J compares this income and expenditure. It shows that the Government generally spent more overseas than was available and, though the cumulative overspending during 5¾ years only amounted to £340 million, it was a chronic drain on Government overseas resources which contributed to the necessity for Government overseas borrowing. If Government overseas expenditure is greater than its overseas income it must borrow the difference overseas.

This factor was never mentioned at all during the flurry about the Balance of Payments in recent years. Perhaps this is because it was conveniently concealed in official statistics as part of the "current balance" which embraces the Private Sector **Import/Export balance;** as well as **Interest etc.** from Private Overseas Investment; and **Government current overseas expenditure,** as though all were part of our Import/Export trade. While the Government was castigating the Private Sector for the unfavourable "current balance" no mention was made of the part played in it by the Government.

It is also interesting to note that the Government actually restricted Private Sector Overseas Investment which, though at times it contributes slightly to the load on our Balance of Payments, at least adds to our overseas

TABLE J

GOVERNMENT OVERSEAS EXPENDITURE ON CURRENT ACCOUNT AS A COMPONENT OF GOVERNMENT OVERSEAS DEBT

	Private Sector Interest, Profits, Dividends, and Current Transfers	Government Overseas Expenditure Current Account	Net Balance	Outstanding Government Overseas Monetary Debt
	Annual Balances			
Dec. 1964	+ 514	- 551	- 37	
65	+ 576	- 581	- 5	
66	+ 542	- 632	- 90	
67	+ 542	- 638	- 96	
68	**+ 551**	**- 696**	**-145**	
69	+ 780	- 787	- 7	
Sept. 70	**+ 635**	**- 595**	**+ 40**	
	Cumulative Balances from Jan. 1964			
Dec. 1964	+ 514	- 551	- 37	573
65	+1,090	-1,132	- 42	1,172
66	+1,632	-1,764	-132	1,481
67	+2,174	-2,402	-228	2,067
68	**+2,725**	**-3,098**	**-373**	**3,363**
69	+3,505	-3,885	-380	2,664
Sept. 70	**+4,140**	**-4,480**	**-340**	**1,611**

assets and provides a steady flow of foreign income to meet Government overseas expenditure. It is notoriously a mistake to strangle a goose which lays golden eggs!

The two new factors in our Balance of Payments

Table K is a summary of currency flows from Jan 1964 to Dec 1968 and to Sept 1970 respectively. The figures are taken from the 1970 Pink Book but are re-arranged in such a manner as to distinguish between the **old** familiar factors which have always influenced our Balance of Payments and the two **new** factors—**Loans to Developing Countries** and **Export Trade Credits.**

This table only shows the changes in each factor over the two periods. Thus between 1964/70 Government Overseas Loans and Export Credits **increased** by £1,716 million but the **total** of these two items at September 1970 was **£3,061** million which—less Import trade credits of £382 million—is the true measure of the load they were imposing on our Balance of Payments.

Government loans to developing countries

Government "Loans to Developing Countries" is one of the new factors in our Balance of Payments, in the sense that only in recent years has it imposed any serious load on our Balance of Payments. Today it is one of the only two factors which still oblige the Government to borrow overseas.

TABLE K

SUMMARY OF ALL FACTORS IN THE BALANCE OF PAYMENTS

extracted from the 1970 Pink Book but rearranged to draw attention to the New Factors

£ million

	Cumulative Balances from January 1, 1964 to			
	Dec. 1968		Sept. 1970	
OLD FACTORS to which we have become accustomed				
Private Sector Trade in Goods and Services (Table F*)		**- 687**		**- 78**
Private Sector Interest, Profits, and Dividends (Table J)	+2,725		+4,140	
Public Sector Services, Transfer and Official interest (Table J)	-3,098	**- 373**	-4,480	**- 340**
CURRENT BALANCE		-1,060		- 262
Private Sector Foreign investments	- 621		- 599	
Euro $ borrowing for investment overseas (Table H)	+ 288	**- 333**	+ 462	**- 137**
Import Trade Credit		+ 94		+ 382
Sterling balances: changes in foreign holdings		- 758		- 49
Foreign currency transactions of U.K. banks		- 268		- 238
Other short term flows		+ 20		+ 52
Public Sector Capital flows (other than official financing and inter-Govt. loans to Developing Countries)		- 352		- 469
Balancing item (errors and omissions)		+ 115		+ 444
NET TOTAL of old factors		-2,542		- 277
NEW FACTORS				
Export Trade Credit (Table M)*	- 852		-1,383	
Government loans to Developing Countries (Table L*)	- 282	**-1,134**	- 333	**-1,716**
TOTAL CURRENCY FLOW		-3,676		-1,993
FINANCED BY:				
GOVERNMENT OVERSEAS BORROWING short and medium term less repayments		**+3,363**		**+1,611**
Other Official Overseas Settlements		+ 313		+ 382
		+3,676		+1,993

***Note:** The figures in this Table are for the periods January 1964/December 1968 and January 1964/September 1970. Therefore they do not agree exactly with Tables F, M and L which cover different periods.

TABLE L

GOVERNMENT LOANS TO DEVELOPING COUNTRIES

	Total Outstanding £ million	
Dec. 1958	68	
59	108	
60	162	
61	216	
62	264	
63	306	Increase 333
64	370	
65	418	
66	473	
67	529	
68	588	
69	639	

Table L shows the outstanding balance of these loans at the end of each year from 1958 when the figure was trivial. By 1963 it had risen to £306 million and by the end of 1969 it stood at £639 million. Between 1964/9 these loans increased by £333 million, yet they were scarcely mentioned as a factor in our Balance of Payments.

One cannot help wondering whether Parliament exercises any control at all over these Loans and what arguments are used by officials who recommend them to Ministers. Are they recommended on Political or Commercial grounds? A part of these loans may be spent in Britain and appear as Exports but the rest is spent abroad and there is no fund of foreign currency available to the Government from which to meet this foreign expenditure so the cash must be borrowed overseas.

Unhappily there are two kinds of Sterling. Sterling in the hands of a foreign Government is "First Class"—it is equivalent to the $ and is freely convertible. Sterling in the hands of a U.K. citizen is "Second Class"—it can only be converted into foreign currency by permission of the Bank of England.

Government Loans *to Developing Countries are clearly* treated as foreign currency loans in the Pink Book which shows them as an increase in Government overseas Assets financed by an increase in Government overseas Liabilities.

Since the Central Statistical Office treats these Loans in the same manner as it treats all our other overseas loans it must be assumed that they are regarded as sound investments which will eventually be redeemed and in the meanwhile earn interest.

If they are sound investments it is difficult to understand why a Developing Country in need of a loan should not obtain it from the International Banking system.

One can imagine circumstances in which security for a particular loan was *inadequate, but the British Government* could then come to the aid of the Developing Country by guaranteeing the interest and, if necessary, the capital. The consequent reduction in Government overseas debt would greatly strengthen Sterling.

Loans to Developing Countries could also be dealt with by transferring the whole problem to the Private Sector. If a Developing Country requires goods or services on credit the Private Sector could provide the credit and negotiate suitable terms. In special circumstances the Government could guarantee the loan.

Whichever may be the best way of dealing with these Loans, it is evident that the total should not be allowed to increase and that it would be in the national interest if a large part of the outstanding balance of £639 *million could* be hived off—perhaps to the World Bank.

Export trade credit

Export Trade Credit is the second **new** factor, in the sense that only in recent years has it played a serious part in our Balance of Payments, but it has now become the principal cause of Government overseas debt.

Export credits increased by £1,383 million between January 1964 and 30th September 1970, by which time they stood at a total of £2,422 million. If these credits had been dealt with in a different manner there need have been no Government overseas debt at September 1970.

Since the war there has been increasing Government pressure on the Private Sector to export more and more goods in the belief, which we regard as mistaken, that it would be possible by the various devices which have been used to tip the Import/Export balance permanently in our favour so as to provide a regular surplus of foreign currency with which to pay off Government overseas debt and finance future Government overseas transactions.

This pressure has taken many forms ranging from exhortation to the award of honours to those reputed to have made an outstanding contribution to the export drive, not to mention financial aid to exporters which for the most part took the form of pressure on the banks to finance export credits.

The most surprising aspect of the whole matter is that Export Credits have never been officially mentioned as a major factor straining our Balance of Payments. **Table M** shows how rapidly they grew.

One can only assume that the Authorities did not realise what was happening or else that they were reluctant to admit that Export Trade Credits had become the principal cause of Government Overseas debt.

Of course, at first sight, there appears to be little connection between the exporter who gives credit to his overseas customer, and Government overseas borrowing. Nevertheless there is a positive link between money advanced to an exporter by a British bank to enable the exporter to give credit to his overseas customers and Government overseas borrowing, though the intermediate steps are hard to follow.

TABLE M

GOODS EXPORTED ON CREDIT

	Value Outstanding £ million
Dec. 1962	619
64	813
66	1,216
68	1,803
69	2,224
Sept. 70	2,422

The simplest way to explain the connection is to consider the first six months of 1970 when our Import/Export trade was not only in balance but was slightly in our favour. In so far as we paid for Imports on the nail but Exported goods on credit the result was that, though the value of Imports and Exports was in balance, the Outflow of foreign currency to pay for Imports exceeded the Inflow of foreign currency from Exports because part of the exports was supplied on credit. The difference was found by drawing on our Gold and Currency reserve at the Bank of England which the Authorities automatically "topped up" by Government overseas borrowing.

In short the net result of Exporting goods on credit is to impose a strain—and, as will be seen from the figures, a prodigious strain—on our Balance of Payments which pushed the Government into overseas debt.

An increase in Export Credits appears on the other side of our International Balance Sheet as an increase in overseas Assets, just as an increase in Private Sector Overseas Investment appears as an increase in overseas Assets.

The important point is that the immediate effect under present circumstances is to increase Government overseas debt which, as we have repeatedly pointed out is widely regarded as evidence that the financial position of Britain is unsound in spite of the fact that the Overall Financial Position of the Nation has steadily improved.

Indeed, as we have remarked, Government overseas debt of £1,611 million last September compared to our gold and currency reserve of only £1,111 million was treated by a number of overseas observers as evidence that Sterling was in jeopardy.

It is clearly undesirable that Government Overseas Debt should continue; moreover it is unnecessary for the Government to borrow overseas in order that goods may be exported on credit, because the British banking system is well able to arrange for Export Credits to be financed by Private Sector overseas borrowing which does not create the same unfavourable impression.

This is no hypothetical proposition. Japan has been doing it for years. The Japanese Government was also anxious to stimulate exports so it also encouraged exporters to give long credit to overseas customers but, in order to save the Japanese Government from overseas debt, the Japanese banking system borrowed overseas whatever was necessary to finance Japanese export credits.

The British banking system is at least as competent as the Japanese banking system. With a little encouragement from the Government it could easily arrange for British Export Credits to be financed by Private Sector Overseas Borrowing through the banking system. This might involve paying a higher rate of interest. If so, it simply means that exports are now being subsidised because if a foreigner can buy British goods on credit at less than the International interest rate it is a subsidy.

This proposal would neither be Inflationary nor would it make it more difficult to export, save that exporters might have to pay a higher rate of interest. The Private Sector would simply borrow overseas in place of the Government.

The burden of our argument has been that Government Overseas Debt undermines confidence in Sterling. Accordingly Government Overseas Debt should be eliminated as soon as possible. The whole Government Overseas Debt at September 1970 stemmed from Government Overseas Loans to Developing Countries and Export Credits. Both could be financed by the Private Sector without altering the balance of overseas assets and liabilities of the Nation as a whole, but Government Overseas Debt would be extinguished and so Sterling would be regarded as a good deal more secure.

The internal effect of Government stimulation of exports

Table N gives the Import/Export figures for twenty-two years. It confirms our repeated assertion that, over any long period, Imports and Exports have always been in equilibrium (see the totals for the 22 years); that the balance in any particular year has been a trivial percentage of the whole Import/Export trade for that year; and that balances have promptly been corrected in subsequent years. The figures also confirm that Official attempts to tip the balance permanently in our favour have failed.

We maintain that while rates of exchange are fixed, the Government can only tip the balance of trade in our favour so as to yield a regular surplus if it is willing to pursue a deflationary monetary policy compared to other countries. This is how Germany achieved a favourable balance of trade. In relatively deflationary conditions home costs are low compared to foreign costs. This encourages exports and damps down imports.

The figures plotted as a graph (see page 32) show that a surge of Imports is invariably followed by a surge of Exports, and vice versa. What is equally interesting is that our Import/Export trade has steadily increased and has done so in periodic surges which are in rhythm with surges in the interantional trade of the whole Western World. (See Research Paper "National Recovery 3".)

This is not the place to explain the mechanism which causes the Import/Export trade of the Western World to surge in rhythm but it certainly does so and did so conspiciously in the early nineteen fifties. It is a worthy subject for a future study.

The exact mechanism by which our Import/Export trade has been held so closely in balance is not clear but the

TABLE N

Private Sector
IMPORT/EXPORT TRADE
Goods and Services

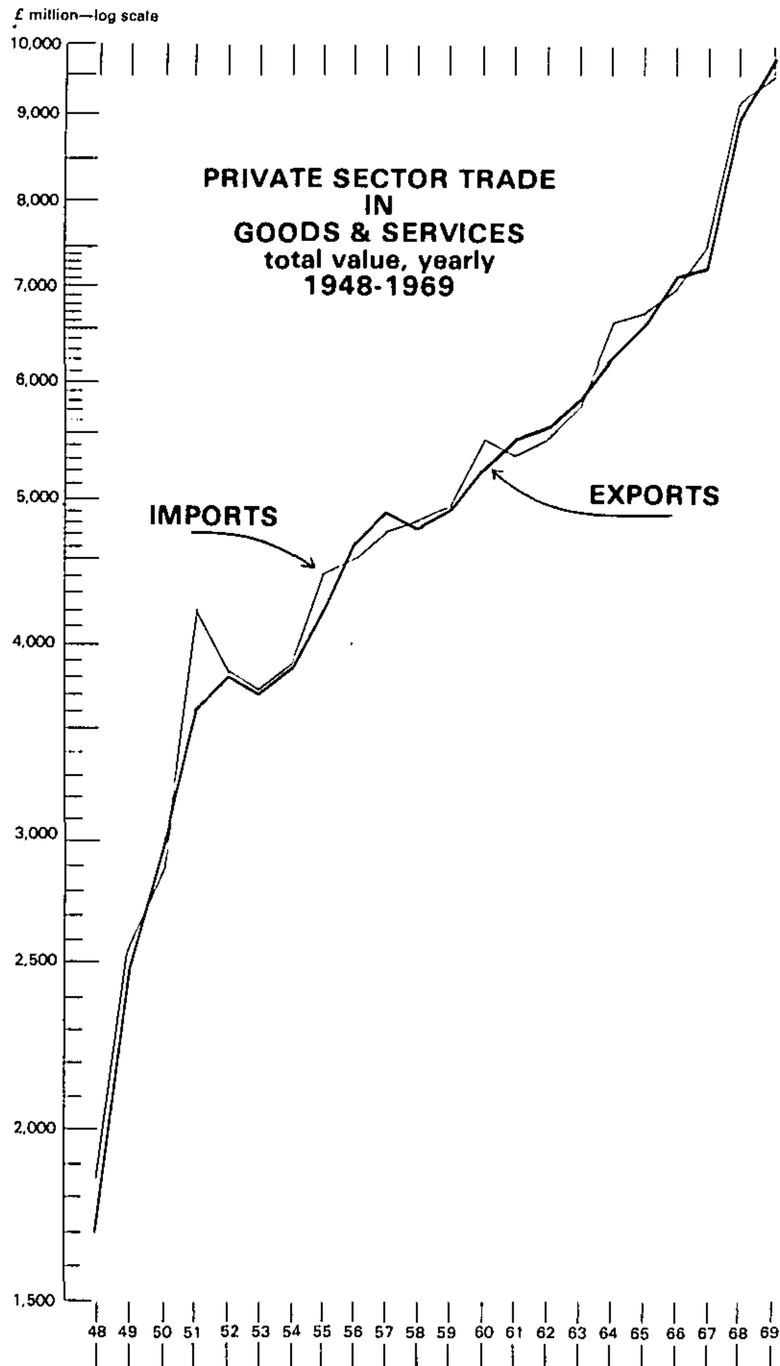
£ million

	Exports	Imports	Balance	Balance as % of Imports/Exports
1948	2,196	2,351	-155	3.4%
49	2,495	2,557	- 62	
50	2,995	2,940	+ 55	
51	3,648	4,173	-525	6.7%
52	3,813	3,841	- 28	
53	3,719	3,737	- 18	
54	3,859	3,861	- 2	
55	4,199	4,390	- 91	
56	4,623	4,469	+154	
57	4,841	4,713	+128	
58	4,756	4,486	+270	2.9%
59	4,907	4,797	+ 10	
60	5,208	5,422	-214	1.9%
61	5,433	5,357	+ 76	
62	5,576	5,437	+139	
63	5,888	5,784	+104	
64	6,193	6,551	-358	2.8%
65	6,621	6,693	- 72	
66	7,079	6,946	+133	
67	7,251	7,467	-216	1.5%
68	**8,803**	**8,977**	**-174**	**1.0%**
69	9,852	9,429	+423	2.2%
Totals	113,955	114,378	-423	0.18%

Note: The Balance in any year seldom exceeds 3% of the total Import/Export turnover for the year but, as total turnover increases, a 3% balance will be larger and will have greater effect on the Balance of Payments so Government Overseas Reserves must be increased.

Example:

1948 total turnover £4,547m 3% = £136m
1969 total turnover £19,282m 3% = £578m.



record suggests that Government intervention only played a small part in it:

(a) Because it was in balance for many years before the Government started to intervene

(b) Because, since then it was also in balance for a good many years when Government intervention was slight

(c) Because, when the Government did intervene, it was generally with the declared object of securing a consistently favourable balance over a number of years which it never achieved.

In the meanwhile one cannot help asking whether the present forms of Government intervention designed to increase Exports are wise. An increase in Exports has always been followed by an equivalent increase in Imports so it is hard to see the advantage to the Nation.

When this argument is advanced there is a tendency to quote such statements as "we must export or die" or else "we must export more to pay for the increases in essential Imports", but the figures show that these parrot cries are unrealistic. "Essential imports" are generally defined as:

food, beverages and tobacco (why is tobacco included?)

raw materials

fuels

The rest of our Imports are comprised of manufactured goods which require further processing (e.g. mechanism of a watch to which a case is added in England) and finished manufactured goods, most of which are patently less essential.

Table O shows that between 1964/9, in spite of the population growth and the increase in production and exports, the value of Essential Imports only increased by 17 per cent (most of this increase was accounted for by additional fuel imports) whereas the Import of less essential manufactured goods almost doubled. Thus, there was no question of Exporting to save the Country from death.

TABLE O

THE INCREASE IN ESSENTIAL IMPORTS COMPARED WITH THE INCREASE IN LESS ESSENTIAL IMPORTS

Monthly Figures	1964	1969	Percentage increase
Food, beverages, tobacco	147.6m	160.8m	9%
Raw materials	93.2	104.4	12%
Fuels	48.6	75.5	55%
TOTAL Essential Imports	289.4	339.7	17%
TOTAL Less Essential Manufactured goods	180.0	344.8	92%

Apart from the advantage of increasing consumer choice, it is by no means evident that this artificial stimulation by the Government, which is what it amounts to, of our whole Import/Export trade is in the national interest, though Government Export Credit Guarantees should be preserved as a protection for British exporters against political risks.

In spite of the fact that most other Western Governments seem equally bent on expanding their exports—it might well be found, if more information was available, that Britain would be better off if our Import/Export trade was allowed to develop under the influence of normal market forces without Government intervention which tends to distort the internal economy in undesirable ways.

An example of distortion caused by Government intervention in commerce is the credit which has been made available to foreign customers to persuade them to buy more of our Exports which has starved our internal commerce of credit and pushed the British Government into overseas debt.

Total export trade credits outstanding in September 1970 amounted to £2,422 million of which at least half is shown in official statistics as directly financed by banks and the rest by the exporters themselves though they were certainly also borrowing from the banks.

At that date the banks were lending a total of £3,250 million to Companies (of which a very generous slice went to exporters). In addition the banks were directly financing goods which had already been exported to the tune of £1,106 million, so it would appear that something like half of all bank lending to Companies at that date was for the purpose of enabling foreigners to buy British goods on credit.

Since the Government imposed a "ceiling" on total bank lending, but at the same time encouraged banks to finance Exports, the banks have been financing exporters at the expense of those who do not export with the result that a great number of manufacturers and service industries have become desperately short of cash.

Exporters are generally large Companies **dependent** on a host of smaller specialised Companies for their components. The smaller component manufacturers seldom export much directly so they find it difficult to obtain credit from their banks. At the same time the finances of these small companies have been grossly strained by their large exporting customers who demand excessive credit on the grounds that their cash is tied up in exports. So a vast number of smaller manufacturers and service organisations have been subjected to a DOUBLE CREDIT SQUEEZE.

We suggest that it would be in the national interest if less money was tied up in supplying goods to overseas customers on credit. If the credit situation in Britain was less distorted it would reduce the strain under which much of British industry is now operating and so our internal commerce would become healthier and more efficient.

To put the situation in homely terms—Official enthusiasm to increase exports has resulted in selling £2,422 million of British goods to foreigners on tick at the expense of British industry and British citizens who have been so squeezed of credit that they are desperate. At the same time the operation has put the Government in hock overseas to the tune of £1,611 million.

Summary of conclusions

1. **Government overseas monetary debt** should be eliminated since it undermines confidence in Sterling.

2. Government **Loans to Developing Countries** might be better provided by the international banking system or else by the British Private Sector, supported if necessary by a Government guarantee. This would get rid of a factor which now pushes the Government into overseas debt.

3. It would be in the national interest if **export credits** were financed through the British banking system by borrowing from the international banking system. This would enable all outstanding Government overseas monetary debt to be repaid. However, Government Export Credit Guarantees should continue in order to protect British exports from political risks.

4. **Government stimulation of exports** by present methods does not seem to be in the national interest. Indeed, we do not think that an exporter is more virtuous or more deserving of honours than someone who supplies goods to the home market and so contributes to improving the quality of life in Britain.

5. Publication of the **Visible Balance of Trade** should be discontinued. It inspires totally misleading and often alarming comment in the Press. If anything is to be published it should be the combined Visible and Invisible Balance.

6. Publication of the **Gold and Currency Reserve** by itself should be discontinued since it no longer has any significance. More frequent publication of the overseas assets and liabilities of the nation as a whole would be instructive.

7. It would be helpful if references to the **Current Balance** showed the Public Sector and Private Sector components separately.

8. Reference to the **Basic Balance** might well disappear altogether.