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Review of "Cyclical Movements in the Balance of Payments"

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do many other Europeans—that the United States chronic export surplus cannot be eliminated by relying on depreciation of foreign currencies or on voluntary capital exports by American investors. The dollar gap appears as a permanent feature of the international trade picture, which could be made to disappear, as far as Europe is concerned, only by a faster rate of technical progress in western Europe and the development of new commodities acceptable to American consumers.

The theoretical parts of the book offer little new, but the statistical part is rather original. The main burden of Niehans' argument of the persistence of the dollar gap rests on the perverse elasticity of demand for imports in the United States. But whereas most authors who have dealt with this problem have confined themselves to measuring the elasticity of demand for imports in general, Niehans rejects this approach. His chief arguments against a "global" elasticity of demand for imports are (1) that the concept of elasticity of demand in a strict Marshallian sense is applicable only to a commodity and not to an aggregate or bundle of commodities; (2) that the lumping-together of commodities has the tendency of yielding a lower elasticity figure than justified; and (3) that the global elasticity figure makes no allowance for distinguishing between imports with an elasticity of demand greater or smaller than unity.

The procedure used by Niehans, therefore, consists in selecting eighteen commodities which together, in 1948, accounted for 45.8 per cent of all American imports and in estimating the short-run (less than one year) and long-run (more than one year) elasticity of demand for each commodity (based on postwar prices and imports). He finds that, on the whole, short-run elasticities tend to be below unity, whereas long-run elasticities are about evenly divided between "luxury" consumption goods and tropical foods, with elasticities less than one, and industrial raw materials (wool, copper, newsprint, etc.), with elasticities greater than one. It is clear that the two groups of commodities call for different price or depreciation policies if it is intended to close or narrow the dollar gap.

A number of objections of similar seriousness to those raised by Niehans against the usefulness of a global figure of import elasticity could be leveled against his method: (1) Niehans uses less than half the American imports; even assuming that his estimates of the elasticities of demand for these commodities are accurate, it is impossible to deduce from this information the elasticities of demand for other imports; (2) tariff levels for different American commodities influence the elasticity of the relevant section of the demand curve, so that a decline in the tariff might have a different effect on the quantity demanded of an imported commodity than a proportional depreciation of the currency of the exporting country; and (3) the figures on the basis of which Niehans computed his elasticities do not appear to insure the accuracy of the elasticities found by him.

Niehans' policy recommendations therefore can be derived also from a general appraisal of the structure of United States imports. His analysis reveals, however, that a closing of the dollar gap is more usefully tackled by treating different commodity imports differently than by attacking the problem from the global viewpoint of general depreciation. He then argues—in my opinion, correctly—that unilateral downward adjustment of American tariffs is a more suitable policy measure than relative appreciation of the dollar and that the major efforts in the long-run attempts to close the dollar gap should be directed to opening the American market to new commodities altogether or such commodities as in the past have been effectively excluded from competing in this country by virtually insuperable tariff barriers.

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Cyclical Movements in the Balance of Payments. By TSE CHUN CHANG. London and New York: Cambridge University Press, 1951. Pp. x+224. $3.75.

Dr. Chang's announced purpose is to "show the pattern of cyclical behavior [in the balance of payments] particular to each type of country; and to suggest in the light of the Keynesian theory of employment, a possible explanation for the general nature of the equilibrating process in the balance of payments" (p. ix). What he succeeds in doing is to verify that the relative amplitude of fluctuations in international trade was greater than the relative amplitude of fluctuations in the level of real income (for most countries and for the world) during the period he studied (1924–38).

Equilibrium in the balance of payments "is

reflected in an offsetting equality between the variation in the balance in income account and that of the net long-term capital movement. The variations in both are normally influenced and determined by the world trade cycle" (p. 7). The empirical sections of the volume indicate that a high correlation exists between exports and imports, on the one hand, and the appropriate income and relative prices, on the other, and also that the income elasticities of demand for exports and imports are higher than the price elasticities. The existence of serial correlation in all the data used means that these relations which are derived by means of logarithmic linear correlations are highly questionable. As the time series of long-term capital movements generally show an offsetting movement, the dynamic equilibrium in the balance of payment is achieved by these capital movements canceling the trade balance. When these two items fail to offset each other completely, "the balance of payments of a country is temporarily out of equilibrium [and] international short term capital movements and changes in international cash reserves [also exchange rates?] act as the balancing item in closing this gap; and when acting in this way their movements are passive" (pp. 221–22).

In the context of this study the Keynesian theory of employment seems to mean that the income elasticity of the active items (long-term capital movements and the trade balance) are high. The genesis of the world trade cycle is nowhere studied, and the process by which a change in world income determines the behavior of the constituent elements in the balance of payments is nowhere clearly stated, let alone tested. As a result of the so-called "passive" nature of the movements in the monetary items in the balance of payments, it is possible for Dr. Chang to write a volume on the balance of payments in the 1920's and 1930's and ignore the monetary and banking systems of the period. The picture of the balance of payments in this volume is that, as a result of a rise in world real income, the industrial nations will develop an export surplus and at the same time they export long-term capital; that the agricultural countries will develop an import surplus and simultaneously import long-term capital. This relation between the balance-of-payment items and the level of income has meaning as a description of what occurred. However, as these items are not shown to be dependent upon the operations of any market mechanism, these statistically estimated relations are purely fortuitous.

A modern version of the adjustment process in the balance of payments cannot keep income effects and monetary effects in separate compartments and certainly cannot relegate monetary effects to a passive role. The income effects are necessary if the model is to reflect the rapid adjustment in the balance of payments that takes place in the world. However, unless the marginal propensity to save is zero in the export-surplus country, the operations of the income effect will leave the balance of payments in disequilibrium. The shift in international liquidity, which this implies, will either result in equilibrating monetary effects or it will result in a breakdown of trading relations. In the period under study by Dr. Chang such a breakdown of trading relations occurred.

Long-term capital movements are shifts of disposable income among countries. Such a shift of disposable income will increase the expenditures of the borrower. A meaningful analysis of the role of long-term capital movements in the balance of payments would test the hypothesis that long-term capital movements induce an offsetting movement in the trade item.

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Psychological Analysis of Economic Behavior. By GEORGE KATONA. New York: McGraw-Hill Book Co., 1951. Pp. vii+347. $5.00.

This book represents a solid, sober, down-to-earth attempt to apply field theory and Gestalt psychology to economic problems. Consumer plans and motives, attitudes toward income, assets and expenditures, spending and saving, business motivation, output, price, and investment decisions, behavior during economic fluctuations—all are examined from the psychological viewpoint. The surveys of consumer finances, carried out by the Survey Research Center of the University of Michigan for the board of governors of the Federal Reserve System and the Survey of Liquid Asset Holdings, both directed by the author, are used extensively.

Dr. Katona characterizes the traditional approach to psychological questions in economics as "economics with mechanistic psychology" (p. 7). He suggests, to replace it, "psycho-