The Dollar and Our National Purpose*

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When I spoke to you just two years ago, most of us were preoccupied with the difficult problem of checking pronounced inflationary tendencies, which were evident throughout our economy, without at the same time inhibiting desirable economic growth. By and large, the efforts of monetary policy along these lines during 1959 were working not only in behalf of a healthy domestic economy but also in the direction of an improved balance of payments. While monetary policy can take only a part—perhaps a small part—of the credit, the objective of checking a dangerous inflationary psychology was very largely accomplished. Unfortunately the twin objective of full use of our resources was not achieved. To what extent this was due to the disrupting influence of the steel strike may never be measured accurately. In any case, full recovery was not attained before new recessionary tendencies began to appear, and therefore monetary policy began to swing over early in 1960 from restraint to ease.

As softness in business conditions persisted and became more accentuated, the resultant weakening of credit demands, together with a Federal Reserve policy of monetary ease, brought a substantial decline in short-term interest rates. And as this was reflected in a considerable flow of short-term capital from this country to Europe, reaching a peak in the summer and early autumn of 1960, it was demonstrated that monetary policies that were clearly helpful from a domestic point of view were having some effects that were not helpful to our international financial position. The result was that we were led to devise a policy that would assure ample availability of credit for as long as it was needed, but would at the same time hold the outflow of short-term capital from our shores to a tolerable limit. This is still the basic frame of reference for our current actions.

During the past few months the position of the dollar has been subject to more questioning and eyebrow-raising, here and abroad, than at any time in the last quarter century. I shall try to show a little later on why I think these doubts on the dollar have been unwarranted. But the mere fact that they exist is of the utmost importance to us. After all, the dollar is the foundation on which all of our international economic relationships—and in fact many of those of the entire Free World—have been based throughout the period of postwar reconstruction and development. We cannot allow any cloud on the dollar's reputation to persist.

In a sense this concern about the dollar has come at an appropriate time, for the nation is apparently in a healthy mood of self-examination, of reappraisal of our broad objectives and our means to attain them. For lack of time and knowledge, I shall not dwell on the political and military aspects of this self-examination. But in the economic sphere the primary fact confronting us today is the urgent need of the underdeveloped areas of the world for sound advice and tangible assistance in achieving a better standard of life. I believe there is general recognition in this country that we cannot shirk this obligation—to ourselves as well as to the world we live in—and that the total economic assistance forthcoming from the industrialized nations must increase rather than decrease. The average man's common sense tells him that a country rich enough to afford our standard of living is rich enough to do its part in this world task—and I am confident that the same feeling exists, and is in fact increasing, in the more prosperous countries of Western Europe. But where this popular understanding breaks down is in drawing the necessary conclusions as to the need for self-discipline—in the matter of costs and prices and in fiscal and monetary policy—if we are to translate this inherent ability to create a better world into practical accomplishment.

We bankers and central bankers are often accused of placing too much stress on financial soundness, to the detriment of human objectives. Yet most of the bankers I know are no less mindful of these human needs than is the average citizen; they are, however, often better acquainted with the limitations set by our economic and financial structures—and with the choices to be faced if monetary stability, a basic requirement of sound growth, is to be preserved. They are aware that, if the nation wishes to do more in the public sphere, either at home or abroad, its citizens must be willing to pay for these outlays through taxation. And while it would be pleasant if this taxation could be made painless by having economic growth provide these additional resources automatically

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within our present tax structure—or better still within a lower tax structure—we must also recognize that in periods when needs outstrip growth there will have to be conscious choices and perhaps conscious, but purposeful, sacrifices to meet these needs. At such times, given the already steep rates of taxation on income, additional revenues might well have to come from taxes on some of the less essential types of spending that now compete for our resources. Furthermore, when the question involves provision of assistance abroad, we must recognize that there is an additional hurdle—the hurdle of our international balance of payments—which must be overcome before resources available in this country can be made available abroad in a form that will not do violence to the dollar's stability.

So much has been said and written about the United States balance of payments that I shall try to be mercifully brief on this tortured but vital subject. For purposes of this discussion, I shall assume that in present circumstances the "hard-core" balance-of-payments deficit—exclusive of short-term capital movements—is in the neighborhood of $2 billion annually. As is inevitable when a large number of items of inflow are lined up against an equally large number of items of outflow, there is no mathematically valid way of attributing the difference between total inflow and total outflow to one or more specific causes. Thus, our balance-of-payments deficit could be ascribed to inadequate exports, excessive military outlays, too much foreign assistance, or excessive United States investments abroad, depending entirely on the analyst's point of view.

Just as there is no single cause, there is also no single or easy cure for the deficits of recent years. A solution must be pursued vigorously along many different paths, not only by ourselves but also by our major trading partners, for whom the preservation and strengthening of the international payments mechanism is no less vital than for ourselves.

As to our exports, we can at least point to a very healthy rate of expansion in the past year, with the favorable merchandise trade balance recently running at an annual rate of better than $5 billion. This is a high figure historically, even after allowing for the favorable effects of a European boom; but it is not high enough, in view of the continuing heavy demands on our resources. My own judgment is that our position in the world obliges us to strive for even larger exports, and this means above all a need to keep our costs and prices as competitive as we can to make them. Fortunately, our effectiveness in attaining this goal should also contribute importantly to achieving substantial economic growth with reasonable price stability.

The various measures announced by the President last November to reduce American military expenditures abroad, and to tie our aid to developing countries to our own exports, should have a salutary, if gradual, effect on the favorable balance for total trade and services. There are other measures which can help to achieve a better trade balance, such as removal of quantitative import restrictions abroad, lowering of excessive foreign tariffs, and removal of special unilateral incentives to American tourists to import duty-free foreign products (such incentives having been initiated largely as a conscious aid to closing the late-lamented "dollar gap"). In a parallel situation in the immediate postwar years, when the United States ran a stubborn payments surplus, we took the lead in reducing tariffs and extending aid to others, in order to bring about a better international balance. While I recognize that "tying" has no place in normal private international trade and lending, large-scale public assistance probably does justify "tying" for balance-of-payments reasons—and help "in kind" under such circumstances seems clearly preferable to a reduction in the amount of assistance.

There is no doubt in my mind that greater sharing of the burdens of foreign assistance and the defense of the Free World offers one of the most promising possibilities for betterment in our balance of payments. Here we are up against the difficult problem of finding appropriate "yardsticks" for dividing such burdens. Granted that there will never be complete agreement as to the relative importance, for this purpose, of the various countries' domestic national income and of their ability to handle the burden from a balance-of-payments standpoint, I am sure that a reasonable compromise can be achieved among men of good will seeking a common objective. The very persistence of large surpluses in some countries' balance-of-payments positions could, in some circumstances, be taken as a rough indication that they might equitably undertake more of the burdens of defense and foreign aid. Already I have been impressed by the fact that many responsible leaders in Europe recognize that something along these lines can and must be done; and I believe that we shall see tangible progress on this front in the coming year, possibly centered around the co-ordinating activities of the new Organization for Economic Cooperation and Development.

Perhaps the most puzzling aspect of our whole balance of payments is the role played by private long-term investment. Many of you are probably familiar with the analysis wherein the United States payments deficit is equated with our outflow of funds on private long-term capital

account, leading to the conclusion that the problem is not too serious, since we are acquiring productive investments which will ultimately provide a heavy return flow of interest and dividends. Recognizing the validity of this argument from the longer term standpoint, we must still face the problem of how to meet the balance-of-payments deficit here and now. One aspect of the matter that deserves study is the effect of existing United States and foreign tax laws on the flow of such investment and on the transfer of earnings to this country. There is the related question whether our tax laws should not differentiate between the less developed and the more industrialized countries, since special incentives are still appropriate for the former.

Another significant problem of our international private investment program is the growing tide of nationalism in countries which have been major recipients of long-term American capital. Granted that long-term private investment on a world-wide scale remains a most promising source of higher living standards everywhere—just as it played a major role at one time in developing our own country—we should be rethinking some of these related problems which seem to be diluting some of the great mutual benefits of international investment. Perhaps some vehicle for the internationalization of private equity investment might have fruitful possibilities, although direct investment by corporations will probably continue to be the mainstay of private investment.

Assuming as I do that by various means we can soon eliminate our "hard-core" deficit, two related questions may still remain unanswered: First, will we thereby remove a necessary source of world liquidity? Second, will the dollar still be in an unduly vulnerable position in the event that short-term capital outflows, and induced gold outflows, should threaten confidence in our currency?

On the first point, it has been argued that the United States should deliberately continue to run moderate deficits in its balance of payments—averaging, say, one half a billion to a billion dollars annually—in order to add to total foreign reserves of gold and dollars over the long run. This would tend to follow from the fact that United States balance-of-payments deficits over the past decade have in fact been a major source of needed additional monetary reserves of European and other countries, and hence have helped to fill a need for world liquidity that could not have been wholly met from limited new gold production. There may be some force in this argument, if we take the long view, although I am persuaded that for the near future there is ample international liquidity and no need for us to incur deficits to meet such a need. Moreover, in the longer run, United States contributions to world liquidity should be the result of deliberate decisions made at our discretion, rather than the chance by-product of excessive spending and lending abroad in relation to our resources. The final answer to the tenability of such deficits depends on whether we can maintain sufficient faith in the dollar so that modestly higher aggregate short-term liabilities in relation to our gold holdings are supportable. This leads to consideration of the second question.

If our basic balance-of-payments deficit is virtually eliminated—except for cyclical fluctuations that might cause deficits in some years and offsetting surpluses in others—I can see little reason to fear periods of serious loss of confidence in the dollar, *provided* we are pursuing policies at home, both in Government and in the private economy, which are calculated to keep our costs and prices competitive. The balance-of-payments deficit having been corrected, our present gold holdings of about $17½ billion seem ample, both in relation to the world's total monetary gold stock and in relation to the $19 billion of our liquid foreign liabilities (excluding liabilities to international institutions, but including foreign countries' holdings of United States Government notes and bonds, which are of course readily convertible into cash). In a sense the situation is comparable with that of a bank, and a better than 90 per cent ratio of cash to deposits should instill confidence in the minds of the banks' customers. By this crude yardstick, even a considerably lower ratio would probably be feasible. Two objections may be raised to this analogy, however. In the first place, the total of liabilities could be increased suddenly and substantially if large numbers of Americans sought to shift their funds abroad. Secondly, it might be contended that there is no readily accessible central bank, like the Federal Reserve System in the case of a domestic bank, to whom this nation may turn automatically to replenish its reserves in the event of unusually heavy withdrawals. To meet the first objection I believe it will suffice to eliminate the balance-of-payments deficit and to pursue policies at home which guard against long-term erosion of the dollar's purchasing power. To meet the second, it may be pointed out that, besides holding such massive gold reserves, the United States Government is a very heavy creditor on long-term account and that some of these assets could become more quickly available through accelerated repayment by debtor governments; and furthermore it should be borne in mind that the liquid resources of the United States could be readily reinforced through sizable drawings on the International Monetary Fund.

Let me add at this point that, despite the existence of the 25 per cent gold reserve requirement against Federal Reserve notes and liabilities (which requirement is subject to suspension in the event of emergency), there is no doubt

at all in my mind that the primary purpose of our $17½ billion gold stock is to assure the international convertibility of gold and the dollar at the fixed price of $35 an ounce.

I have not yet spoken of ordinary international flows of short-term capital to take advantage of higher rates of return available in foreign centers. To a large extent I think we must look upon these as a fact of life—a natural concomitant of the restoration of external convertibility in most of the world's great trading countries. There is undoubtedly a place, however, for the kind of orderly policies already practiced by many leading central banks—both in framing their own monetary policies and in avoiding abrupt shifts in the proportion of their reserves held in the form of gold—with a view to minimizing heavy flows motivated solely by the attraction of a temporary rate of return. In any case, it seems to me that our present gold holdings provide an adequate cushion to absorb short-term flows of this kind without any appreciable disturbance; but in saying this, I am not unmindful of the desirability of our trying to prevent the spread between our short-term rates and those abroad from becoming unduly wide.

This leads us to a consideration of some of the criteria of domestic monetary policy. At a time such as the present, with large unemployment and unused productive resources in the economy, it is clearly incumbent on us to pursue a general policy of ease that will put the nation's banks in a position to respond to all worthy credit applications, and in fact to seek out worthwhile investment opportunities. On the other hand, I can see no reason whatever, under current conditions, to flood the banks with reserves. For one thing, while this could conceivably have a beneficial influence on longer term market rates, it could do so only at the cost of driving short-term rates to much lower levels, needlessly accentuating the relative attractiveness of interest rates overseas. Furthermore, excessively "sloppy" credit might well discourage the desirable improvements in efficiency and adjustments in costs which tend to accompany any lull in economic activity. As I have said before, we should not expect monetary policy to do more than it can do; and it is very probably too much to expect it to create—all by itself—a new upward movement in business activity. If the inadequate use of our resources should long persist, the time might come when fiscal policy could perform a useful stimulating function. But we should certainly not forget the highly adverse effects on our whole credit mechanism of the unduly large and protracted Federal deficit of the fiscal year 1958-59—and especially the adverse effects of this deficit on foreign appraisals of the dollar's stability.

In closing, it seems to me essential to emphasize the need to avoid all remedies for our balance-of-payments deficit which would be inimical to the kind of world we have been trying to establish, with the aid of our friends and allies abroad, ever since the war—a world of maximum freedom for international trade and international investment. This means that we should shun protectionism in all its forms, with all that it implies in the way of lower standards of living both here and abroad. Further, we should firmly resist any suggestion of exchange controls over the international flow of capital funds or other international payments. Such action would not only be futile but would also defeat the whole purpose of our international economic policy. But above all, as I am confident both the outgoing and the incoming Administrations would agree, there must be no tampering with the present fixed relationship between gold and the dollar, at $35 per ounce, and the readiness of this country to deal freely in gold, at this price, with foreign central banks and governments. I am certain that only harm could come from any depreciation of the dollar in terms of gold; and I am equally certain that this country has the will and the necessary resources to maintain this firm foundation of our whole international financial structure.

The beginning of 1961 is appropriately a time for re-examination of our objectives and our national programs for attaining them. I hope that no conservative will be so unbending as to deny the need for a constructive approach toward the full use of our resources both at home and in the world at large; and I hope that no liberal will be so rigid as to deny the vital importance of conducting our affairs in a way that assures firm confidence in the dollar. If we can adopt such a constructive approach, I am sure we can avoid panicky or unwise actions —and we shall be able to look back at the international problems of these days as providing a useful discipline for the shaping of sound and imaginative programs.