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COMPETITIVE EFFICIENCY AND THE BALANCE OF PAYMENTS

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COMPETITIVE EFFICIENCY AND THE BALANCE OF PAYMENTS

My subject today is a double one. Before I try to couple the two parts -- "competitive efficiency and the balance of payments" -- I'd like to say a little about each of those two things by itself, just as if competitive efficiency had nothing to do with the balance of payments and vice versa.

Let's start with the balance of payments. I don't intend to give you a lot of facts and figures today, but I do want to present you with a basic idea as the foundation for this discussion. This basic idea is: The United States is at the center of the present monetary system of the free world, and to keep our position of leadership in the world we must keep the dollar a currency in which people all over the world have confidence. I am going to lead around to this basic idea by raising the question of what is meant by a deficit in our balance of payments.

Here in New England you have something that can be called a balance of payments between New England and the rest of the country. I don't think anybody has ever been able to put together all the figures that would be needed to demonstrate in black and white just what New England's balance of payments is; but, with or without exact figures, the balance of payments does exist, every day and every year. You export to the rest of the country, and you import from it. You get tourist expenditures from the rest of the country as well as investment income. You pull in savings into your life insurance companies, and in turn you send out some of these savings, and some of New England's own savings go into loans and investments all over the

United States. Adding up all that comes in and deducting all that goes out produces a figure that is your balance of payments. As long as you receive more than you pay out, you have no immediate worry; but if you were constantly running a deficit on this balance, you would be losing your money to the other parts of the country and, among other bad effects, conditions of unemployment would get worse. I realize that many of you already have a thorough understanding of symptoms that would accompany a persistent balance-of-payments deficit, as well as the necessary steps in restoring an economy to a healthy condition.

People seldom think in terms of a deficit or a surplus in New England's balance of payments. I doubt that anybody ever pays much attention to whether the Federal Reserve Bank of Boston is losing gold to the Reserve Banks of the other eleven districts or is gaining gold from them. That would be one way of measuring the surplus or deficit in New England's balance of payments, if you wanted to measure it. But the fact is that only a few worry about New England's balance of payments because it takes care of itself pretty well most of the time.

Now, why _is_ this? Well, there are quite a lot of different adjustment processes, which work successfully, without the awareness of most people that these adjustments in New England's balance of payments are going on all the time. For example, if interbank clearings and settlements for one reason or another were suddenly piling up reserve balances for a lot of New England banks -- so that the interdistrict settlements were producing big gold credits for the

Federal Reserve Bank of Boston -- it wouldn't be very long before the New England banks would be putting some of that money to work in the Treasury bill market or the Federal funds market, or buying some other Treasury securities. The result might be partly just a reshuffling of reserves within the district, but also funds would be moving back to other districts. This is one way in which equilibrium would be automatically restored in New England's balance of payments.

You can probably think of other examples of adjustments -- some adjustments of a surplus, some of a deficit, some that would work almost as quickly as the one just described, and others that would take much more time. For example, if you had a tendency for a persistent deficit reflecting an import surplus, a tendency for deposits to drain out of the First District for expenditure in other parts of the country, a tendency for unemployment to rise and incomes not to keep pace with incomes elsewhere, one of the adjustments you would be sure to think of would be the development of some efficient new industries in New England. Of course, much misery and human suffering could go on until such adjustments were successfully made. One example would be a man who is out of work for several months with his family dependent upon him for food and clothing. Another, less commonly thought of as hardship, is the man who tries to start a new business, barely misses, and loses all of his savings, possibly along with those of others. It is because adjustments <u>are</u> going on all the time that the balance of payments between New England and the rest of the country is kept in reasonable balance.

The international balance of payments of the United States is not quite so simple. Today it is causing many people to worry. The Government in Washington pays attention to it, and the Federal Reserve Board keeps it in mind along with all the other things that it has to consider in shaping monetary policy.

It's worth stopping a moment to ask why the balance of payments of the United States is something to worry about and the balance of payments of New England isn't. One difference is simple enough: In one case it's all inside the country and in the other it's between us and foreign countries.

But that's too simple an explanation to suffice. What it comes down to is a whole series of differences:

(1) Each country has its own government finances and its own government securities; each has its own monetary policy.

(2) Each has its tariffs that hinder free movements of goods.

(3) Each has its immigration regulations that hinder free movements of people.

It used to be that there were exchange controls that hindered movements of capital, too, but in Western Europe those have been rapidly dropping out of the picture in the last few years. Even so, there are important differences between making loans and investments in your own country and making them in some other country. What all these things add up to can be briefly expressed by saying that each country has its own currency.

When we say the United States had an over-all balance-of-payments deficit of $3.7 billion last year, we are measuring the deficit in a somewhat different way than I used in talking about the inter-district gold settlements that settle the New England balance of payments every day. In other words, it's not only the gold movements that count. Last year our gold transactions with other countries amounted to net sales of $1.1 billion. But in addition to that, the rest of the world took payment from us for what we owed them on the year's transactions in liquid dollar assets -- bank deposits, Treasury bills, bankers' acceptances, and so on -- amounting to $2.6 billion more. The size of the deficit we had to worry about last year was the sum of these two figures, $1.1 billion plus $2.6 billion, or $3.7 billion. This year it looks as if the deficit will certainly be somewhat smaller, and perhaps a good deal smaller, but it is too early to say just how much smaller.

Someone could say, isn't that $2.6 billion of increase in foreign ownership of liquid dollar assets last year very much like the New England banks buying U.S. Treasury bills when New England has a balance-of-payments surplus with the rest of the United States? Yes, and no! As long as the foreign holders have confidence in the U.S. dollar <u>and are willing to go on building up their dollar holdings</u>, the two cases really are <u>not</u> so very different.

But can we count on the foreign holders to continue building up their short-term lending to us in this way? After all, it's our currency, not theirs. Dollars are useful to them in international transactions, but there is some limit to the amount of dollars that business concerns and banks in other countries will want to hold at any given stage in their development and growth. If they want to use some of the money at home, they have to sell dollars to their central banks (or to someone else willing to buy) and get their own domestic currency in exchange.

Then the foreign central banks, having bought the dollars, have to decide what <u>their</u> duty is: Is it all right for them to hold their monetary reserves in dollars or should they ask us to sell them gold for the dollars? The answers will depend partly on their habits and customs, which differ from one central bank to another. We can be sure of one thing: When the answers are all added up together, the total answer will be, "Yes, we'll hold some more dollars, but only so long as we have confidence in the value of the dollar and its international convertibility. If the dollar ever looks as if it's going to lose its reputation, let us out!"

That's the real clue to the difference between the New England case and the United States case. Regardless of the section of our country in which we live, we are all in this money business together. Our money is yours. If we have inflation, you will too. No one is going to change the exchange rate between the dollar in Washington and the dollar in Boston.

As you can see, the U.S. Government does have to worry about the country's <u>international</u> balance-of-payments deficit, even when the deficit isn't all settled in gold. In one way or another, the Government has to foster conditions that help us move towards a reasonable equilibrium in the balance of payments. We must be sure that foreign businessmen and foreign central banks (and Americans too, for that matter) can rightfully go on trusting in the value of the dollar and wanting to hold even more dollars than they have.

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Now I'll turn to the first half of my subject -- "competitive efficiency." When we think about it, that's the thing that has made the United States what it is today. Emerson said: "If a man has good corn, or wood, or boards, or pigs, to sell, or can make better chairs or knives, crucibles or church organs, than anybody else, you will find a broad hard-beaten road to his house, though it be in the woods." There is nothing so American as the passion for efficiency, for doing things in new ways, and for doing them well. This is what has given the American consumer the tremendous range of choice he has in what he can buy with his earnings. In our system, it is the consumer who has the last word. The ultimate purpose of all our competitive efficiency, beyond the pure satisfaction of doing things efficiently, is to satisfy the consumer.

In these last few years we have been learning, or relearning, several important things about competitive efficiency on the national scale.

One pair of facts we have been relearning is this. First, when the general price level is reasonably stable, the tests of competitive efficiency become much more stringent and effective than when people can count on making inventory profits or capital gains out of rising values even with an inefficient enterprise. Second, as soon as some general spur to competitive efficiency begins to operate on a fairly broad scale, the responses of our producers can be surprisingly vigorous, and efficient competition can play a very important role in maintaining general price stability. While the Federal Reserve System has the responsibility for keeping the creation of new credit and money in balance with the nation's capacity to produce, that is only one part of the job of preventing inflation. It also depends on producers holding down their costs and prices and improving their efficiency. Granting that it is a great help if there is an atmosphere of reasonable stability to begin with and an over-all balance between supply and demand, still it is remarkable how efforts to improve competitive efficiency can pay off for the country at large, both reinforcing the stability of the general price level and giving the consumer good products at good prices. As we all know very well, this is something every business must keep working at all the time.

Another thing we have relearned in these past few years is that the scope of competition is not only local or national, but international. This brings me finally to my main subject, which is competitive efficiency <u>and</u> the balance of payments.

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As I see things, our balance-of-payments difficulties of the last couple of years, insofar as they are due to rising competition from Europe and Japan, have produced some desirable results. After a period in which more and more people seemed to be talking and acting as if creeping inflation were inevitable, it has been heartening to see the healthy response our country has made to the challenge of foreign competition.

General business newspapers give example after example of the ways American producers have been adapting themselves to the new facts of life. We read of new products, new processes, new plants, modernization of old plants, new cost-cutting ways of arranging production or distribution, new resistance to unwarranted wage demands. The list is long.

In the list is also the solution of setting up production abroad. I do not condemn this; it is often a good, or even the best, solution for some companies to do some of their manufacturing abroad. One thing I regret in connection with this process is that it will tend to make one of our domestic problems bigger. That problem is unemployment. Estimates are that during the last half of this decade we will be adding 1,500,000 yearly to our labor force, compared with recent figures of 800,000 per year. Obviously, this problem will require much attention in the years ahead. Another thing I regret is that too often the really dominant motive in building a factory in another country has not been one of pure efficiency, but rather the motive of getting inside some trade control barriers or some tariff barriers abroad. We can't blame the American companies for doing this. The lesson to be drawn here is that the U.S. Government must make greater efforts through international negotiations to eliminate foreign restrictions on our products.

Along with this reminder that barriers do still exist, I must call your attention to the progress the European countries have made in reducing discrimination against dollar purchases -- within the general framework of their trade barriers. The movement toward convertibility, of which a part and parcel was getting rid of currency discrimination, has played a very significant role in the restoration of a healthy and vigorous Europe.

There is a lesson for us in this European experience that fits in exactly with what we have been relearning for ourselves about the benefits of efficient competition. The lesson is that we simply can't afford, in our own long-run interest, to let tariff and trade barriers grow up here against foreign competition. We need the spur and stimulus that free competition can give our producers in raising their competitive efficiency.

If we continue to meet foreign competition this way, we can feel confident about the future of our dollar and of the continuing position of leadership of our country in the economic and financial affairs of the free world. Yes, we are the leaders of the free world. But, in this era of international competition, a leader will not long remain a leader if fun is placed ahead of the responsibilities of leadership. We are in for a real test. Eventually we, or our children, will get the verdict as to whether we are worthy descendants of the hardy pioneers who came to the shores of this country with little more than hope.