

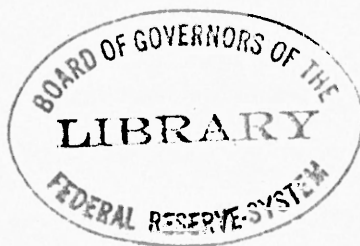
FINANCIAL ASPECTS OF WORLD LEADERSHIP

Remarks of C. Canby Balderston, Vice Chairman,
Board of Governors of the Federal Reserve System,
at the Mellon National Bank and Trust Company

Correspondent Bank Meeting,

Pittsburgh, Pennsylvania,

September 20, 1961.



SEP
1961 26

HG
2561
.B2

FINANCIAL ASPECTS OF WORLD LEADERSHIP

The leadership of the Western World seems to be our American role of the moment. Our international responsibilities are different and far heavier than those prior to World War I, or even World War II. The course of history has placed burdens upon us that are heavier than most citizens seem to realize despite all they read concerning the parlous state of world affairs. Perhaps the essentials need to be stated more directly than is usually done.

World leadership has many faces. One is political, supported by its knight in armor--military force. A second is economic, supported by an underpinning of financial soundness. It is of economic leadership that I shall speak.

If world trade and all it means to the industrialized nations is not to suffer, the integrity of the dollar must be protected. It is used not only as a medium of exchange, both at home and abroad, but as a store of value. Although these two uses may be cited for any national currency, the dollar is almost unique in that, together with the pound, it also is used as a reserve currency by the central banks of the world.

I start, then, with the importance of preserving world confidence in the value of the dollar in relation to other currencies. This has taken on new significance since the renewal of currency convertibility among the industrialized countries of Western Europe, Britain and Japan at the end of 1958. As funds can now flow from one financial capital to another with great facility, those responsible for funds are quick to shift them if they fear that the dollar will lose in value as against

other currencies, or if rates of interest are sufficiently higher in other countries to induce a transfer. If traders and/or speculators fear that the dollar will decline in value relative to other currencies, they are inclined to bid against the dollar in a variety of ways. For instance, they will be tempted to speculate by selling dollars and buying some currency whose value they think will rise in relation to the dollar. Still other traders will engage in the game of leads and lags. German importers, for instance, who have to make payments in dollars to American exporters, will prepay their bills if they believe that the dollar is going to gain in value relative to the German mark, but they will delay payments if they believe that the dollar will depreciate. In short, the dollar, as used in international trade, is subject to all the vicissitudes of any currency that is free from restriction, but the stability of the dollar is of special importance to all countries that use it as a reserve currency.

So much for the case for preserving the stability of the dollar if the United States is to retain its financial leadership and prestige. To this must be added the oft-discussed reasons to safeguard the savings that have been accumulated. Destruction of the savings of the past not only does damage to those who rely upon them in old age, sickness and adversity, but to the saving process that undergirds technological progress and enables it to be utilized.

The more difficult problem is to determine how the integrity of the dollar is to be preserved. The essential point is that, to pay for our new investments abroad, plus the military expenditures and economic

aid across the seas that our world leadership seems to entail, our exports must exceed our imports sufficiently. This means products of the right design and quality offered at the right terms and prices. Our country is rich in resources and in management know-how. But how much it can invest, spend and lend abroad depends basically upon how much more it exports than it imports. This means that our firms must be competitive in the world's market places, which are coldly realistic.

Nor is the problem one for private industry alone; government must provide a non-inflationary climate through its monetary and fiscal policies. The world is constantly appraising our spending in relation to our taxing. Since 1947, the Federal debt has increased from \$257 to \$290 billion, and there have been some serious deficits since 1958. The increase in Federal debt is not as disturbing, in view of the growth of GNP and the national income, as the tendency for observers around the world to wonder if recurrent budget deficits signal difficulty ahead in maintaining the value of the dollar, especially if we do not have surpluses in boom years to match in size the deficits of lean ones.

Dr. Arthur F. Burns gave a prescription as to how to meet our economic challenge in his talk last May to the American Iron and Steel Institute:

"* * * unless the government moves prudently in increasing the money supply and its own rate of spending; unless trade union officials keep their demands for wage increases from exceeding improvements in general productivity; unless the government refrains from passing laws that raise wages or prices; unless business firms and trade unions join in

efforts to remove restrictive labor practices and the featherbedding in which both executives and workers sometimes indulge; unless the government reforms our tax system in the interest of stimulating greater effort, more productive investment and higher efficiency; unless business men innovate vigorously and lower prices whenever possible; unless these things are done and a liberal policy toward imports is continued, we will not avoid new and successive rounds of inflation."

Recently our trade balance has been favorable. During the second quarter of 1961, American exports were running at an annual rate of over \$19 billion and our imports at an annual rate of about \$13.5 billion. Although this appears comforting, it must be remembered that our investing, lending and spending abroad has exceeded our favorable trade balance in all of these last ten years, excepting 1957, with the consequence that the people and institutions of other countries have accumulated claims against us. They hold short-term claims against this country of some \$17 billion. If foreigners (or for that matter, Americans), because of fear or other reasons, exchange the dollars they hold for some other currency, the dollars go eventually to the central bank of the country involved. If that central bank has a policy, as do many central banks, of keeping its dollar holdings below a fixed maximum, then it of course converts the excess dollars into gold. This leads to the gold outflow of which so much was heard last fall. With a gold stock balance of around \$17 billion, which is nearly half of the gold reserves of the western world, our country certainly has enough to conduct its business both as a great exporter and as the world's leading banker. But just as any

banker must conduct himself with prudence, our nation is watched as to the direction in which its gold reserve is moving and especially as to the underlying causes of that movement. In short, our financial and competitive prospects undergo continuous and critical appraisal.

I turn now to the capacity of American firms to compete in world markets. Perhaps a resumé of post-war changes will be helpful. The United States emerged from World War II with an enormously expanded plant capacity, with a store of technological improvements that stemmed from war research, and with a population that, despite its tragic losses of dead and disabled, was basically unharmed. Britain, Holland, and Norway had suffered markedly in loss of plant as well as of trained manpower. Germany, Austria, and Italy had fared even worse. These devastated countries had to rebuild their plants as well as their homes. In the post-war years, the desire for our goods in such areas was apparently insatiable. The buying power to acquire these goods was provided under the Marshall Plan with such generosity as to enable these countries to get on their feet and become good customers. But they also have become strong competitors with plants as good or better than our own.

Meanwhile, a long period of operating without foreign competition in the post-war sunshine of abundant demand for materials and equipment had a softening effect upon our industries. For some years they received orders without aggressive marketing and, since increases in unit costs could be passed on to the consumer so long as post-war inflation abroad made price increases possible, they got themselves caught in a wage-price spiral that has had unhappy consequences. The heritage from the war of highly mechanized production techniques and of the fruits of research was a technological breakthrough that gave to the United States a great competitive

advantage in world markets as long as the industries in other countries were engaged in replenishing their domestic needs. Once they had caught up with basic needs at home, however, the newly equipped foreign plants, employing labor at a fraction of the comparable rates of this country, entered world markets with many products that were as good as our own and cheaper, too.

Although we have exported and financed an unprecedented \$20 billion worth of goods during the past twelve months, we must not forget that some of our best customers have been enjoying a boom. Consequently, they have needed our materials and equipment and have been in a position to buy finished consumer goods as well. In demonstration that our present trade balance is the product of boom conditions abroad, we need look back only as far as 1959 to find a month in which we actually imported more than we exported.

Despite the fact that an annual import total of less than \$14 billion in relation to a national income of about \$420 billion is small, our ability to compete in our own domestic markets is vulnerable to improved and cheaper products from abroad. Foreign-made glass now comes by ship right into Toledo--which had won the name of "The Glass City" of America by producing much of the glass used in our American autos. Much of the barbed wire, reinforcing bars and wire nails we use are now of foreign origin, not to speak of a substantial amount of semi-finished steel. We import Japanese transistor radios and electric parts that are cheaper than ours, and Japanese ball bearings and cameras of as fine quality as can be found anywhere. It is not that we fail to export; rather it is that our trade surplus fails to finance the obligations of world leadership.

The competitive edge given us by the post-war breakthrough in mechanization and automation has now been lost in many lines of product. Sophisticated foreigners know that if we inflate more--and they less--they can take foreign markets away from us and make greater inroads into our home market as well. It did not suffice for us to keep our costs steady when German, French and Japanese costs were decreasing. If their costs should now rise and ours hold steady, then time should work for us. But the mere passage of time will not work in our favor unless we make those hard decisions necessary to keep prices competitive in world markets. Compared with 1953, Japanese and French export prices, expressed in dollar terms, have fallen by 6 per cent, whereas those of the United States have risen by around 10 per cent. The fact that the United Kingdom's export prices have risen 10 per cent since 1953 is perhaps more indicative that its problems continue than that ours have been solved. Since that year, the export prices of our manufactured items have risen by perhaps a fifth, while the prices paid for the raw materials we have imported have shown little change. And so we need to look to the fundamentals.

There are products on which we have reason to have a comparative advantage in world trade, and we must make the most of that advantage. In the private sphere, wage-setting and pricing decisions need to reflect the realities of the world of the 1960's if we are to create rather than lose jobs. When we fail to export items on which we have a comparative advantage, we lose job opportunities. This happens when our labor, despite our mechanization and technical know-how, is priced out of world markets. Of equal importance are governmental spending and monetary policies. If these

should bring about an inflationary climate, American costs will rise relative to those in other countries that show better financial husbandry. Our competitors have demonstrated sufficient self-discipline to make the U. S. a probable loser if it counts on other countries being still more imprudent. Our task, instead, is to demonstrate our mettle to them. Although there is no easy short cut to sound financial management, there are few obstacles that determination and self-discipline can not conquer.