THE AMERICAN DOLLAR

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The once proud American dollar has been shaken from its place of eminence in world currencies. The dollar has been in trouble and every unfavorable development has set off a fresh spasm of concern around the world. In a short telecast a few weeks ago, President Nixon moved the problem to center stage.

Perhaps the most frequent question is: How did we get into this mess? What turned our economy from its posture of dynamic growth into a pattern of stagnation, high inflation, high unemployment, and a weakened currency? The answer is complicated.

International trade and finance involve technicalities and complexities understood only by professionals and not always by them. Without entering into details, which are somewhat mysterious and controversial, the causes of the balance of payments predicament now
engulfing the U. S. can be simply and briefly stated:

1. We have grossly mismanaged our budget and fiscal affairs, incurring deficits, piling up debt and allowing the dollar to decline in domestic purchasing power to less than half its value 40 years ago.

2. We have had enormous self-conceit in financing the defense of the democratic faith throughout the world.

3. We have been indifferent to the widening gap between the cost of labor and productivity.

In consequence, we have flooded the world with dollars and priced ourselves out of a good part of the international trade market.

The oversupply of dollars naturally resulted in a great weakness of the dollar in foreign exchange markets.
Because attitudes play such an important part in the value of any currency, the apprehensions among world financiers intensified the very weakness that frightened them. Speculation against the dollar mounted steadily.

Early in August, gratuitous advice flowed freely from leading European merchant banks. They included: get out of the Viet-Nam war, cut military costs in Europe, curb corporate investment overseas, and keep interest rates high enough to attract both foreign investments and hot money.

Increasingly, though, European financial men appeared convinced that the U.S. would not take enough such steps quickly enough to avert dollar devaluation.

One European banker commented, "Certainly it is difficult for us to dictate monetary policy to a nation as strong as the United States, but," he boasted, "we can discount their dollars if we have to take
them and the less we like the dollars the more we can discount them."

Vacationing Americans learned with a jolt what this meant by first-hand experiences. Hotel cashiers handed over no more for the dollar than was necessary. Americans with travelers checks paid high premiums to get Swiss francs, German marks, Italian lira, and French francs. The dollar was treated as a second-class currency.

A substantial part of our current problems stems from the long inflationary binge since 1965. Through 1968, the inflation was generated by large budget deficits connected with the Viet-Nam war which created excessive demand pressures in an already fully employed economy. More recently, however, a kind of inflation has emerged that has not responded to the classic prescription for control. It has been described as a wage-cost push, a product of the extravagant terms
of wage contracts imposed by labor leaders on business concerns under the threat or the impact of industry-wide strikes. Both parties have been aware that the high cost of such wage deals would be passed along to consumers in higher prices.

Certainly, the more an individual worker can add to product, the better should be his pay. In lieu of individual measurement, output per manhour is used as a yardstick for productivity gains in the private economy. A wage increase determined by productivity gain would not require offsetting price increases. Hence, it would not be inflationary.

Wage increases that equal total increases in output would be in error, however, since this would impute the entire gain in productivity to labor. The fact is that productivity gains are a result of the joint contribution of all productive factors.
A more equitable distribution would allow some part of the productivity gain to the owners of capital. Going a step further, the general well-being would be enhanced if some part of the gain were shared by consumers through lower prices.

We should have learned several lessons in dealing with recurring crises over the last decade. If these lessons are ignored, we can expect some of the difficulties to linger or reappear.

The popular view has been that when international policy needs conflict with domestic economic goals we could somehow muddle through international problems without a great deal of loss. International transactions may not play as large a role in the U. S. economy as they do in other nations, but their importance is nevertheless significant.

From mid-1970, attempts to stimulate growth in output and employment with a still high rate of inflation was undoubtedly frustrated
in part by a high rate of imports. Yet these imports were a symptom, of a much more fundamental cause; that is, the cumulative effects of a high rate of inflation during the latter part of the 1960's that had made U. S. producers increasingly less competitive with foreign producers. Reducing imports through quotas or other means without restoring U. S. competitiveness would only have dealt with symptoms while aggravating inflationary pressures.

The August 15 actions in the international area and the responses of foreign governments will have widespread effects upon American consumers and businessmen. These actions do not automatically solve our international difficulties. Rather, they put the rest of the world on notice that we were no longer willing to attempt the resolution of our difficulties under what had become an increasingly less workable international payments system.
Meanwhile, our officials have expressed a desire and a willingness to negotiate a new system, a system that would be more equitable in sharing the burdens of international economic adjustments and hopefully in the long run would benefit all nations.

American consumers must now pay higher prices for the variety of foreign goods, such as cars and televisions that we import. These higher prices may have the effect of marginally reducing the real standard of living of many Americans.

In contrast, a number of American businesses competing with foreign imports will gain some temporary advantages, since the price competition from foreign producers will be less severe. But unless these companies increase productivity, such advantages soon may be dissipated. Other American businesses may find their costs rising as a result of the higher prices they must pay for imported foreign components.
Many large American corporations and banks with extensive overseas operations are already finding that the wide array of foreign exchange controls are hampering their operations. Consequently, these controls may reduce foreign earnings of these corporations and banks, as well as earnings of private Americans who have invested in foreign stocks and other foreign securities.

We should have learned that no nation can deal with its international difficulties alone. No actions taken by this country to deal with its balance of payments deficit can succeed if other nations pursue policies designed to maintain lasting surpluses.

One such matter is the question of equitable sharing of defense and economic aid expenses. If other countries are prepared to permit a currency realignment that could restore a significantly large surplus in the U. S. balance of merchandise trade and services, then offshore
dollar defense expenditures and dollar aid outlays might continue to be carried by this country without incurring continued large U. S. balance of payments deficit.

Everything considered, however, it might be politically less onerous for our trading partners to accept a larger share of the defense and aid cost rather than impose upon their own industries the competitive disadvantages that would be implied by a large U. S. merchandise trade surplus.

All that one can be sure of is that it will be virtually impossible for equilibrium to be restored to the U. S. balance of payments unless either a large U. S. trade surplus or a more equitable defense and economic aid sharing is agreed upon.

On the other hand, if we expect the cooperation of other nations, we must exercise responsibility in restraining inflation in such a way
as to minimize any adverse impact of our own economy upon other
nations. Our dominant size in the world economy and correspondingly
massive influence on the economies of other nations make this
responsibility particularly acute. To put it in other words, we cannot
pursue a policy of "benign neglect" toward the rest of the world.

The difficult lesson we have learned is that these international
problems cannot be solved solely by financial policies. At the same
time, through growing and frequent central bank consultation, the use
of central bank swap networks, the creation of special drawing rights,
and other developments, we have made significant advances in dealing
with many international monetary problems.

There has been a tendency to rely far too heavily upon monetary
policy to achieve both domestic goals and international equilibrium
while applying international tax, trade, and investment policies in a
piecemeal and often haphazard fashion.

In fact, past policies may have significantly delayed needed international adjustments by distorting such flows. Consequently, the international adjustments that must be made now are likely to be more difficult and painful.

The unilateral move by the Administration to close the gold window and apply a 10 percent import surtax is fraught with risk. One danger is that foreign governments may respond somewhat emotionally, perhaps erecting trade barriers to U. S. products in retaliation for our actions.

Most U. S. officials and businessmen are convinced that however guilty this country might be in the maintenance of such trade barriers, most other developed countries are much more guilty. If this is the case, U. S. merchandise trade performance is being adversely affected
by artificial restraints in addition to the burden of our past inflationary excesses.

In the interest of building a better international economic system for the future, however, the present need for sweeping realignments in currency values may also provide a unique opportunity for progress in reducing nontariff barriers to trade and barriers to free investment flows.

In the present world of rapid change, some difficulties have stemmed from our failure to develop new policies to keep abreast of these changes. The Eurodollar market is a prime illustration. During the 1960's, this market grew much more rapidly than the capacity of policymakers and economists to fully understand it, and this failure to understand partially contributed to the aggravation of international monetary problems earlier this year.
While placing restrictions on international trade and investment, policymakers may not have given sufficient consideration to the benefits received from the increasing economic integration brought about by international trade and investment flows.

Shifts in investment patterns by multinational corporations searching for production at lowest-cost sites improve the efficiency of their operations. Countries receiving such investment enjoy a stimulus to economic growth while American shareholders in these companies benefit from increased profits.

If nations are to achieve a sound and workable international payments system, our horizons must be broadened and, ideally, the economic and financial policies of individual nations developed jointly.

At the same time, these policies should be flexible enough to permit the maximum benefits from free enterprise operating on an
international scale just as we derive benefits from free enterprise operating within our individual countries. These benefits include a greater variety, better quality and lower prices on goods available to Americans and, at the same time, maximum returns on investments of both American citizens and businesses. This means keeping restrictions on international trade, payments, and investments to a minimum.

The disarray in international financial markets resulting from the new U.S. initiatives and from the events of recent months that made those initiatives necessary creates both promising and threatening possibilities. If the parties to the negotiations are prepared to be flexible in hammering out new arrangements with an eye to the long-term needs of the international economic system, we have a once-in-a-
generation opportunity to make changes that will benefit everyone.

On the other hand, if the negotiations are stymied by adamant insistence upon short-run national interests so that the talks drag on in an atmosphere of growing frustration and acrimony, then the progress of the past 25 years toward freer movement of goods, capital, and people could be undone. One may confidently trust that all involved are aware of the alternatives and will move responsibly.

In summary, there is an excess supply of dollars held by foreigners above what they require to pay for purchases from us. A moderate devaluation would temporarily favor exports over imports. But it is not a permanent solution. Correction of our adverse trade balance and preservation of the dollar as an important currency in world trade must be done by ourselves, not by others. Competitiveness in
world markets depends:

1. On bringing labor costs into line with productivity;

2. Increasing the rate of productivity gain by upgrading the labor force;

3. Providing it with more and better capital equipment; and

4. Rededicating ourselves to the task of restraining inflation.

As this happens, the surplus dollars held abroad will be sent home in purchase of our exports.

If we fail to pursue policies calculated to bring about equilibrium in our economic relationships with the rest of the world, we can look forward to a rather bleak set of alternatives. We can expect to see the world economy broken up into currency and trading blocks with increasing restrictions placed on international trade and investment. Such a breakdown can be expected to generate increasing economic inefficiency
for all nations. This inefficiency will be reflected in slower economic
growth, lower profits, lower returns on investment, and increasing
inflationary pressures. These are alternatives we, in cooperation
with other nations, must strive to avoid.

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