

THE INTERNATIONAL PAYMENTS SYSTEM AND OUR EFFORTS TO INCREASE FARM EXPORTS

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to the
St. Louis Agribusiness and World Trade Clubs
October 22, 1970

It is good to have this opportunity to discuss with you some vital issues of international trade. Each of us has an interest in this subject - some as producers of goods which compete with imports, others as producers who export part of their output, and all as consumers who gain from the efficiencies of international specialization of labor and resource use.

First, I shall briefly review some historical developments in our international payments system. Then I shall discuss certain policy actions that have been taken to increase foreign trade and, finally, basic factors which tend to limit foreign trade expansion.

Earlier Payments System - Self-Adjusting

In the half century prior to World War I the Western World had a self-equilibrating system of settling international accounts. Most commercial nations were on the gold standard

with the domestic stock of money tied to the stock of gold. A balance of payments deficit led to a gold outflow, which, in turn, led to a reduction in the nation's money stock. A decline in the stock of money reduced domestic demand for goods and services, thereby discouraging imports and encouraging exports. This process continued until the balance of payments deficit was eliminated.

With the monetary disruptions during the war most nations left the gold standard. In the 1920's attempts were made to restore the system, but the relationships established between currencies and gold were often set at the pre-war rates and the currencies were generally overvalued. In those countries where currencies were overvalued imports were stimulated and exports declined, thereby depressing their economies. Nations attempted to make the necessary adjustments, but the depression of the 1930's dealt a death blow to the gold standard before new equilibrium rates could be restored.

Losing gold in a period of growing unemployment meant further contraction of national money stocks and further deflation. Most nations consequently broke the link between gold and domestic money, being unwilling to let international gold movements influence the domestic money stock with the resulting destabilizing effects. Following the

breakdown of the gold standard, most nations moved to a gold exchange system in which national currency values were arbitrarily pegged to the dollar and the dollar pegged to gold.

Current System Not Self-Adjusting

The gold exchange system permits free convertability among major western currencies. Funds flowing out of a country reduce its international reserves just as under the gold standard in former years. Now, however, these flows can be offset by monetary actions, and they have no automatic impact on domestic money and prices. Actions can be taken by central bankers to reduce the stock of money and the demand for goods and services and put a brake on domestic prices when international reserve outflows occur, but such actions now reflect conscious policy rather than the automatic operation of the system. Because of these destabilizing effects, such actions are taken with extreme caution. We are thus at times torn between actions for implementing balance of payments objectives and actions for optimum domestic conditions.

A few nations have altered their exchange rates when large excesses or shortages developed in their foreign exchange accounts. The United Kingdom reduced the value of the pound as a result of a large deficit while Germany increased the

value of its currency following a surplus. This method of changing the terms of trade has not proven a practical solution to the U. S., as the dollar is a key international reserve currency widely held for official balances. Any reduction in its value in terms of gold would result in an immediate loss to all foreign dollar holders.

Other methods used to maintain currency convertability in the case of payment imbalances include tariffs, import quotas, capital export controls, and foreign travel restrictions. Each of these methods, however, tends to reduce the volume of international trade and are, in most instances, arbitrary and subject to extreme abuse by the enforcing agencies.

The special drawing rights (SDRs) activated by the International Monetary Fund (IMF) early this year extended the period over which an imbalance of international payments can occur. These rights essentially increase the quantity of international money by permitting the IMF to create credits to participating nations. Although serving to ease the problem of short run payment imbalances, SDRs do nothing to alter the terms of trade and reverse basic imbalances. Terms of trade between two nations are altered in the market by changes in national price levels and exchange rates. The credits permit more time for a nation to take actions to alter the terms of trade and are beneficial in this respect. Nevertheless, if basic

steps are not taken to equilibrate the terms of trade, an imbalance of international payments on the basis of fixed exchange rates cannot persist indefinitely without total loss of foreign exchange holdings.

Recent U. S. Experience

With this background let's briefly review the U. S. situation with reference to the balance of payments and holdings of foreign exchange. Following World War II, this country had a gold balance of \$24 billion, about two-thirds of the free world's stock of gold. We were likewise endowed with a large proportion of the free world's productive capacity. Justifiably, domestic policies were instituted to provide other nations of the free world with a better balance in foreign exchange. We generally maintained expansive monetary and fiscal policies and engaged in massive foreign aid programs, which tended to reduce U. S. gold stocks. By early 1968 our gold stock had declined to \$10.7 billion, only slightly more than one-fourth the world total. Our gold holdings have since increased slightly, but the basic factors underlying our balance of payments position have not improved.

Our needs for foreign exchange, like an individual's needs for cash balances, depend upon the volume of transactions to be settled. Since international trade by the U. S. accounts for only about one-sixth the world's total, we apparently do

not need two-thirds the free world's stock of gold possessed twenty years ago. Yet, in view of the volume of our international transactions and foreign claims held on the U.S., we do need a sizable stock of gold. Most importantly, however, we require means for altering the balance of payments to avoid further loss of liquidity. To alleviate this problem I would suggest greater flexibility in setting exchange rates between the dollar and other currencies. A system of "crawling" exchange rates whereby the rates are permitted to change a small amount each week or month toward new market levels when imbalances occur would be a major improvement over the current system. By altering rates to meet payment imbalances, the monetary authorities can concentrate on the appropriate actions for domestic stabilization.

Protection, The Major Trade Restraint

Although the international payments system has imperfections, it probably is not the major factor tending to retard trade growth. Policies designed to protect domestic producers from foreign competition have probably been a more important restraint to foreign trade. All commercial nations pursue protectionist policies which reduce the quantity of goods and services available to consumers, and we are equally guilty of this national welfare depressing practice. When the nation was in its infancy, it levied tariffs

for income in preference to domestic taxes. Later, tariffs were raised to protect our so-called infant industries from foreign competition. The protectionist argument still prevails in one form or another. Between 1865 and 1935 our average rate on dutiable imports never fell below 39 per cent, except for the period during and immediately following the First World War when other nations had a very small output of civilian goods for export.^{1/} The Underwood Law in 1914 imposed an average rate of 29 per cent on dutiable imports, which was raised to 39 per cent in 1923 under the Fordney-McCumber Law and further increased to 53 per cent in 1930 under the Hawley-Smoot Law.

Since the Reciprocal Trade Agreements Act of 1934, the nation has pursued an announced policy of "freeing" international trade. Numerous tariff reductions have been negotiated. Nevertheless, duties have often remained so high and other restrictions so effective that export trade has not been greatly affected.

Protection Now Through Nontariff Barriers

While tariffs have traditionally been the chief means of protecting domestic producers from foreign competition, other protective devices have increasingly been used in recent years.

^{1/} Don D. Humphrey, American Imports, The Twentieth Century Fund, New York 1955, p. 74.

Chief among them are import quotas, special clearing agreements, domestic subsidies, bilateral trade agreements, import licensing, and domestic monopolies operating under governmental authority. In some instances the restrictions have involved special legislation. In others, informal agreements have been sufficient to limit trade to arbitrarily determined levels. With the aid of one or more of these measures, nations can maintain tariff duties at relatively moderate levels and still protect producers from foreign competition. This change in method of protection provides an opportunity for great obscurity in discussing trade policies and results of tariff reduction agreements. A reduction in tariff rates may have little meaning since real barriers to trade often remain unchanged.

International trade barriers are as unreasonable under competitive production and marketing conditions as are trade barriers between states, cities, or counties. To the extent that they reduce the international volume of goods and services they reduce welfare.

Our country has not been innocent with respect to the use of these protective devices. Even in agriculture, which has such a large stake in free trade, we have established highly protectionist policies. We have sugar import quotas which, based on the New York wholesale price, cost U. S.

consumers an additional 22 cents for each five pounds of sugar purchased.^{2/} We have subscribed to international trade agreements which set minimum prices on coffee and wheat, thereby limiting trade in these commodities. We have meat import quotas which provide limits on imports of beef. Our cotton export subsidy, designed to offset the trade retarding features of our domestic price support program, is sufficient to permit exports of cotton to Japan and imports of goods made from the cotton to the U. S. for sale in competition with our own mills. In order to avoid excessive disruptions from such competition, however, we have a tacit agreement with the Japanese to limit cotton goods exports to the U. S. Such tacit arrangements are apparently preferred to formalized legal actions, but if they are equally effective in reducing trade, they are likewise equally effective in reducing welfare.

Domestic Subsidies Restrictive

Also important in limiting foreign trade are production controls and subsidies. For a number of years the British have subsidized their farm producers, maintaining excessive labor in agriculture which, in effect, limits their imports and our exports of farm products to them. These workers could earn more in nonfarm pursuits, and under free trade conditions the British would export more nonfarm products and import more farm products, thereby enhancing total production and welfare.

^{2/} International Monetary Fund, International Financial Statistics, Sept. 1970, p. 29.

Our own domestic farm programs inhibit world trade. Despite an announced policy of free trade since 1934 and lower tariff rates, our domestic farm policies have probably offset the advantages gained from the reduced tariff levies. Farm production control and price support programs were initiated in the mid-1930's which contributed to higher farm production cost and higher prices for farm products both here and abroad. Our farm products became less competitive in the world market and worse, from a long range view, was the fact that our policy of arbitrary farm product pricing at higher than free market levels led to a loss of confidence in the U. S. as a long run source of farm products. This move from competitive to arbitrary pricing indicated to our customers abroad that hereafter prices of U. S. farm commodities would be in excess of free market prices. Higher export prices in turn indicated higher food and fiber costs to importing nations. Their costs of imported food thus hinge on the decisions of our price making authorities who are likely to be more influenced by political pressures at home than by living costs elsewhere.

International Trade Retarded

Our tariff reduction policies have not led to more trade relative to total output. In the 1920 to 1934 period, prior to the Reciprocal Trade Agreement Act, U. S. commodity exports averaged 5.1 per cent and imports 4.1 per cent of gross

national product (Table 1). In contrast, since the announced liberal trade policies in the mid-1930's, total exports have averaged only 4.1 per cent and imports only 2.9 per cent of GNP. The proportion of foreign trade in farm products declined even more sharply than the total. Exports declined from 17.4 per cent of farm output in the 1920-34 period to 8.6 per cent since 1934 and imports from 19.9 to 10.9 per cent. In the five years 1965-69 commercial farm exports totaled 12 per cent of cash farm receipts, somewhat above the 1935-69 average but well below the per cent exported prior to the so-called change to more liberal trade policies. Furthermore, export subsidies such as government credits and guarantees, government commodity sales at less than market prices and export payments in cash were responsible for a large portion of recent exports. We view such practices as dumping when other countries export products to us under similar conditions.

Thus, despite our announced freer trade policies, our new barriers to international trade have offset our trade freeing actions. The trade barriers are usually imposed in such a way as to inhibit trade growth rather than have a strong immediate impact, thus becoming successively more restrictive over time.

It is my conclusion that the predominant political forces in most nations today do not really want large increases

Table I
 Relative Importance of Foreign Trade
 to Total U. S. Economy and to Agriculture

<u>Period</u>	<u>Per cent of GNP</u>		<u>Per cent of Cash Farm Receipts</u>	
	<u>Exports</u>	<u>Imports</u>	<u>Commercial Farm Exports*</u>	<u>Farm Imports</u>
1920-24	6.4	4.6	21.3	22.0
1925-29	5.0	4.3	16.4	20.6
1930-34	3.4	3.1	13.5	15.5
1920-34	5.1	4.1	17.4	19.9
1935-39	3.2	2.7	9.6	14.8
1940-44	5.0	1.9	3.1	10.7
1945-49	5.2	2.3	6.0	9.4
1950-54	4.1	2.9	7.4	14.0
1955-59	4.1	2.8	8.0	12.6
1960-64	3.8	2.8	10.0	10.8
1965-69	3.9	3.4	12.0	10.4
1935-69	4.1	2.9	8.6	10.9

* Commercial (dollar) sales; i. e., shipments under specified Government-financed programs are excluded.

Sources: USDA, Agricultural Statistics, Farm Income Situation, and Foreign Agricultural Trade of the United States; U. S. Department of Commerce, Survey of Current Business and The Statistical History of the United States.

in foreign trade. Large gains in trade upset markets and cause changes in resource use. Some hardships occur in the short run in the relatively less efficient industries. Gains occur immediately, however, in the relatively more efficient industries and among all consumer groups. In the longer run all groups gain from the greater efficiency of international specialization. But, neither this nation nor other nations have to date indicated a willingness to adopt policies that will assure these major gains at the expense of minor adjustments among some producer groups.

Restrictive Arguments are Fallacies

Despite the fact that international welfare could be greatly enhanced through freer trade practices, the arguments of trade restrictive proponents have been predominant in determining public policies in leading commercial nations in the last half century. Reasons given for import restrictions are as follows:

1. Large imports of farm products lower domestic prices and farm incomes.
2. It is unfair to domestic labor to compete with producers under "sweatshop" conditions abroad.
3. Imports are not a reliable source of vital products, such as food and critical defense items.

4. Excessive imports damage vital defense industries which are necessary for survival.^{3/}

Implicit in each of these arguments is the belief that import restrictions aid certain producer groups or that some industries are so vital to national survival that we cannot afford to take the risk of relying on imports exclusively for such products.

The argument that import restrictions aid some producer groups is true only in the short run. Over the longer run, labor and other resources adjust to new supply and demand conditions and real gains accrue to all groups. Furthermore, even in the short run such restrictions are at the expense of the rest of the nation.

Let's take agriculture as an example and consider the impact of greater exports of American farm products to Western Europe. Such exports will first cause a reduction in prices to European farmers and a reduction in food costs to European consumers. Their farm incomes will decline, providing incentive for farm workers seeking higher paying jobs in the nonfarm sector. The larger nonfarm labor force which is relatively more efficient will achieve greater output of nonfarm goods and services, and exports of these products to the U.S. will increase. Greater efficiencies will occur in

^{3/} Humphrey, Chapter 7.

both their farm and nonfarm sectors and a larger volume of all products will be available at lower prices, enhancing real incomes and welfare. On the American scene, the larger volume of farm exports will tend to increase domestic farm prices and incomes. This will attract new resources into agriculture from other sectors or more likely reduce the outflow of resources from agriculture. The larger imports of nonfarm products by the U. S. will reduce demand for resources in our nonfarm sector, but, similar to the European case, the increased efficiencies will provide more goods and services to our people.

The argument that imports from low cost factories abroad are unfair to labor is similar to the farm import argument. Import restrictions aid workers in import competing industries in the short run but injure workers in export industries. But, once workers and other resources have adjusted to the new market forces, greater output is achieved and the benefits of greater production efficiency accrue to all.

Almost all major countries subscribe to the vital industries argument for protection. Certain industries are assumed to be vital for national survival. England, for example, has in the past attempted to maintain domestic food production at about 50 per cent of domestic usage. These policies originated from a lack of confidence in supplies from abroad

at critical periods, such as during wartime blockades. Many other nations, including our own, prefer to maintain sufficient resources in vital lines of production to provide a minimum level of output in case of loss of supplies from abroad. Oil and sugar quotas here are an example of such protection. Nations are willing to maintain inefficient production of these vital products despite the fact that such use of resources is a waste of effort. Protection for these industries against competition from abroad maintains stability of employment for a few at the expense of many. Nations are willing to tax more for defense items and pay higher prices for the civilian output of such industries in order to maintain these industries, despite the fact that methods of modern warfare have made such excuses obsolete. Nations now have the power to destroy one another long before supplies of such critical products are depleted. The solution lies in increased confidence that world trade channels will remain open and supply sources unimpaired.

From the standpoint of U. S. agriculture we look abroad at rapid growth of Western European nations and see great opportunities for farm commodity exports, provided these nations will only open their trade doors and invite us in. It is my conclusion that we have not earned the invitation. Despite our numerous pronouncements, our policies have

not contributed to two-way trade arrangements. We have done little to merit the dependence by Western European nations upon us for an indefinite source of vital products at competitive prices. We have neither consistently followed a free trade policy nor domestic pricing policies that are conducive to free trade.

Although the arguments are overwhelming in favor of more trade between nations, I am quite pessimistic as to its future course. Forces tending to reduce welfare through trade barriers are better financed and more powerful than the forces active in promoting welfare through freeing trade channels. As an indication of the power of protective groups, about 590 import quota proposals were introduced in the recent session of Congress prior to the end of August.^{4/} One bill was approved by the House Ways and Means Committee which was described by the New York Times as the "most protectionist and reactionary trade legislation in forty years."^{5/} Signs admonishing us to purchase American goods and protect American jobs can be observed daily. Only the textbooks, however, are available to point out the gains from free trade and few professors are out shouting the story to the general public.

^{4/} International Commerce, Sept. 7, 1970, p. 10.

^{5/} New York Times, Sept. 21, 1970.

SUMMATION

In summary, our international payments system has imperfections. It is not self-equilibrating as it was under the gold standard prior to the 1930's. It has not, however, been the major factor tending to retard foreign trade growth. This growth has been retarded because neither the political forces in this nation nor other nations are willing to forego the short run interests of a few producer groups for the general welfare of the nation.

There are few who deny the gains from greater exports, but powerful groups fear a rise in imports. Both exports and imports enhance total welfare. The removal of trade restrictions would be especially beneficial to American agriculture. We have a major relative advantage in the production of farm commodities. Under free world trade policies and free domestic producing conditions, world-wide food prices could be lowered and world diets improved. The Reciprocal Trade Agreement Act, the recent Kennedy Round and numerous other acts were designed to achieve these objectives. Proposed modern liberal policies, however, are often followed by restrictive actions more typical of the medieval and ancient ages. In practice we still follow the outdated theories of several centuries ago.

Most of the arguments used against free trade practice are not applicable to modern world conditions. The implied disruptions in local industries are generally overstated and are often excuses for maintaining resources in inefficient lines of production. Current unemployment and labor retraining social programs minimize hardships to the labor force resulting from the change. Little capital loss would likely occur with the high rate of obsolescence due to technological change. The vital industries argument is no longer applicable, since, in case of all-out war under modern conditions, no industry is secure regardless of where it is located.

The United States should take the lead in dropping the trade barriers. Tariffs are not the only item to consider. We should move immediately to build world confidence in us as a supplier and market. Real accomplishments will require more than the rhetoric of recent decades followed by high level conferences which tend to free trade where no potential trade exists. We must be willing to reduce barriers and permit major increases in imports and oppose the power of producer groups who have made their short run interest paramount to the welfare of the nation. We must be willing to dismantle our inefficient production controls in agriculture and assure foreign

consumers that our farm products will be available at competitive prices. A move toward free trade is a move toward less Government control of prices and production and greater reliance on market forces for resource adjustment.

These moves are counter to our great surge to alleviate all individual hardships through general legislation which temporarily aids the few but reduces national welfare. Their adoption can reverse the trend to isolationism in the current century and greatly enhance the welfare of both our own citizens and those of the rest of the world.