The Dollar in the World Today*

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As we move into the tenth year of sizable deficits in the United States balance of payments, I am disturbed to find a growing sense of impatience in the American business and financial community, directed less toward our failure to cope adequately with this problem than toward the restraints which the problem itself imposes on the freedom of American capital to move abroad in response to purely private considerations. To oversimplify, there is a tendency to regard all American investment abroad as good *per se* and to look upon those who counsel restraint for balance-of-payments reasons as unrealistic adherents of outworn economic theories.

It is my view that these attitudes, while understandable, are quite wrong and, if given free rein, would result in a breakdown of the whole international financial system which has served world trade and world investment so well since World War II.

Now there is no denying that the United States economy is the strongest in the world today, that the United States offers almost unrivaled opportunities for the investment of short-term funds, and that the dollar is at present used as a vehicle currency for perhaps half of all international financial transactions, in addition to its unique role as a reserve currency for most of the leading industrial nations. All of these facts give the dollar a very large measure of inherent strength; but not even they can guarantee the preservation of that strength, unless we perform adequately on two counts: (1) We must see that the dollar's internal purchasing power is reasonably stable; (2) we must come reasonably close to equilibrium in our balance of payments, on the average, over a period of years.

It has been argued that, to the extent that our payments deficits are offset by an increase in our long-term assets abroad (and in recent years such assets have grown even more rapidly than our cumulative payments deficit), we need not worry "because the bank is decidedly solvent". The point is, however, that we cannot meet a short-term liability, if it is presented for payment, by offering a share in American-owned factories in foreign countries. Like any bank, we must keep enough liquid assets available, in proportion to our liquid liabilities, to inspire confidence in our lasting ability to pay off those liabilities on demand.

Of course, aside from the use of our dwindling gold stock, there are other ways of meeting the temporary pressures that may arise from such liquid claims. A whole spectrum of voluntary cooperative credit arrangements has been built up since World War II, with the International Monetary Fund occupying the central position and with strong support from the Federal Reserve swap lines and other central bank credits, the sale by the United States Treasury of foreign currency bonds, and related measures. These credit facilities have proved their worth in taking care of several massive speculative attacks on major currencies, as well as serious potential pressures on the dollar and a multitude of temporary payments swings; and over the coming years I am sure they can be further refined and enlarged. Incidentally, in the current Middle East crisis, Federal Reserve swap lines and other forms of central bank cooperation have again demonstrated their solid worth. But no amount of credit can ever assure stability if a one-way disequilibrium proves too large and too lasting.

The same comment applies to the current worthwhile efforts to reach agreement on some form of supplemen-

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tary reserve asset which would relieve some of the burden on gold while preserving the usefulness of the dollar as a reserve currency. After all these years of study and debate, it would be very useful to find some agreement on such a contingency plan before too much additional time has elapsed. But no solution of this problem can relieve in the slightest degree our obligation to reach equilibrium in our international accounts.

Far from justifying a more casual and high-handed approach to payments imbalances than in the case of other currencies, the dollar's special position entails special responsibilities for prudent behavior. A country whose currency is held by many other countries as a monetary reserve may have available a considerable measure of automatic credit. On occasion this can be very useful indeed, and clearly there are a variety of benefits accruing to the United States by reason of the dollar's almost universal use as a vehicle and reserve currency. It seems to me wholly reasonable, however, to expect the United States to order its financial affairs in a way to merit the world's confidence in our currency.

There is another aspect of this question which is worth bearing in mind. The attitude of foreign countries toward American investment in their markets varies widely from country to country and, even within a single country, is a composite of differing strands of thought, both favorable and unfavorable. Suppose, for example, that a large United States firm is constructing a new industrial plant that will provide greatly intensified competition for existing domestically owned concerns. The move may be very popular with construction companies which will benefit from the initial investment activity, or with bankers who may handle a large volume of initial financing, or with companies which believe they will be able to buy the products of the new plant more cheaply than would have been possible if the older plants had been the only source of supply. And the officials responsible for development and economic growth may be very well pleased. On the other hand, the move may be anything but popular with the competing companies whose path will be more difficult under the new conditions, and with the central banking authorities who may feel that the additional stimulus is more than can be absorbed without undue inflationary pressure. In addition, there may be those who fear that worldwide United States enterprises may be becoming too dominant in their national economy. On balance, the attitude may be highly favorable. But, if it should become obvious that the United States was deliberately following a policy of fostering overseas investment without any regard for a huge concurrent accumulation of dollar holdings abroad, the balance of forces in the country in question could swing sharply against us, even to the point where severe restraints were initiated against further American investments.

In arguing that we must not and cannot ignore the discipline of balance-of-payments pressures, I am certainly not contending that the burden of adjustment should rest entirely with the deficit country. There are many steps that can and should be taken by the surplus countries to try to reduce their surpluses—steps involving a loosening of restraints on capital exports, encouragement of merchandise imports, the selection of an appropriate mix of monetary and fiscal measures, etc. In the present setting, it seems to me quite reasonable that we continue to call upon Europe for more effective "cooperation" in carrying out its share of the adjustment process.

In so doing, we should neither assume nor imply that we ourselves have done everything that we can to achieve equilibrium. While equilibrium may not prove attainable as long as Vietnam expenditures are at anything like their present level, this does not excuse us from continuing our efforts in this direction. There may be additional possibilities for savings in our public outlays abroad, although here we must of course weigh the political and military factors as well as the financial. But if, as I believe, our best hope of coming closer to payments equilibrium lies in achieving a larger trade surplus, then it is not good enough to feel satisfied if, as in the past year or so, our costs and prices have risen no more rapidly than those of most other industrial nations. Obviously, we must do even better than they if our relative competitive position is to be improved, with consequent benefits to our trade surplus. I think that it is in this area of costs and prices that there is still inadequate awareness, on the part of many Americans, of the vital importance of achieving greater stability. When union leaders and business executives are ready to give this international factor due weight in every wage negotiation and price decision, then we may be well on the way to building the larger trade surplus that we need. And of course appropriate fiscal and monetary policies also play a big role in influencing both the trade balance and other important elements in our overall balance of payments. Progress on these fronts, as well as more effective cooperation by the surplus countries, would open the way to eliminating the kinds of emergency restraints on capital exports which have proved so understandably irksome to our bankers and businessmen. These restraints must certainly be regarded as a necessary evil—desirable only in the sense that they are preferable to the financial chaos that would probably follow from our failure to keep our overall payments under some control.

I might add that, while the restraint on foreign bank lending has been relatively severe, it seems to me that direct investment has been subjected to only rather moderate curbs. The major effort has been to prevent further increases in an outflow which has been at record levels for the past two years, well above the level of the early sixties.

In my judgment, it will not be necessary for us to attain absolute equilibrium, year in and year out, in our so-called liquidity balance. If the dollar continues to perform usefully its function as a vehicle currency to finance international trade and investment, there will undoubtedly be a need for some gradual growth in private dollar holdings. And I would not preclude a gradual growth over the years in the dollar reserves of foreign countries which are prepared to strengthen their financial positions in this way. After all, there is no absolute rule as to the proper relation between our gold holdings and our current liabilities to the rest of the world. In my own estimate, the present relationship between these quantities would be accepted by the world as quite "conservative" if only it could be demonstrated that large continuing deficits are a thing of the past. In the years ahead, of course, the world's entire reserve structure should be strengthened by the addition of some new type of asset.

I hope that I have said enough to demonstrate why I would emphatically disagree with the suggestion of some private citizens that we should perhaps threaten other countries with radical changes in the role of the dollar if they failed to perform in ways that we deemed desirable. Such a threat is only too likely to backfire and defeat our purpose, besides being quite inappropriate to the dignity and responsibility of the world's most powerful nation. It is heartening that our Government has made clear its determination to preserve the dollar's present role.

I regard the fixed relationship of gold to the dollar at $35 per ounce, on both the buying and the selling side, as the very keystone of the world's financial structure. Fortunately this fact is recognized by the world's monetary authorities, and our own Government's unchanged policy with respect to this relationship has been forcefully reiterated on many occasions. Those private commentators who are inclined to make light of this relationship, and even to suggest some measures calculated to alter it, would do well to reflect on the major contribution which this keystone has made to the world's unprecedented measure of prosperity in the years that have passed since the far-sighted Bretton Woods arrangements were first set up. Our best assurance of further growth and prosperity lies in leaving the keystone in place and reinforcing it with appropriate domestic policies and appropriate measures of international financial cooperation.