Remarks of the Honorable John B. Connally Secretary of the Treasury

Editor's Note: *These remarks, dealing with national and international economic policy issues, were presented before the International Banking Conference of the American Bankers Association, Munich, Germany, May 28, 1971.*

The opportunity to participate in this monetary conference has been of great value to me. It is a privilege, and I'm greatly honored by the invitation to share some of my thoughts with you at this closing session.

The hospitality of our Bavarian hosts is alone enough to make it worthwhile being here.

But we are here on serious business at a serious time. We are aware of the strains upon the monetary framework upon which we all depend to carry on our international commerce.

These monetary tensions are a warning. Elements of international monetary cooperation, built with so much effort in the postwar period, are being questioned.

There are also questions about the direction of our policies in the United States. I intend to deal with these questions openly and frankly, lest doubts corrode our purposes and our success. Most importantly, we need to recognize that the disturbances on the surface of the exchange markets are only symptomatic of deeper issues of national and international economic policies.

No group is more aware than bankers that our post-World War II prosperity has relied on the close integration of the world economy and money markets. We have seen nothing less than an economic revolution, with benefits widely shared.

In our exhilaration over the gains, let us not forget that there are costs. Rapid progress in trade and investment has meant vast changes—changes with an uneven impact. As a result, particular industries and even entire countries face difficult adjustment problems.

By definition, an allied international economy implies some squeeze on independent national action.

Basic elements of economic and political power, and responsibilities for leadership, have drastically shifted since the main outlines of postwar policy were shaped a generation ago.

We must recognize, respond, and adapt to these new realities.

Internal stability and social tranquility are legitimate goals of every society, yours and mine. But along the road there are temptations. It is easy to understand how one country or another can be tempted to shirk its responsibilities to the international community, including the maintenance of monetary order.

A stable monetary order requires nations to know and accept the "rules of the game". But let us not confuse cause and effect. It has been wisely said that money is but a veil. Monetary disturbances could help speed the processes of economic nationalism and disintegration. But we would be unrealistic to anticipate workable monetary solutions for essentially nonmonetary problems.

There is no magic that can reconcile incompatible objectives. Money is not a substitute for productive efficiency and competitive strength. It cannot assure fair and equitable trading conditions. The plain danger is that, by expecting too much from the monetary system alone, we may fail to address the underlying need for change in other aspects of our economic life and policies.

What matters most is the spirit and attitude we each bring to this task. Here, I believe we in the United States have a special responsibility to make our approach and intentions crystal clear. I hope I do so.

Our economy is large and rich. We have a high level of trade. Our markets are relatively open. Our currency is a world currency.

Obviously, what we do matters a great deal—not just to our 200 million citizens, but to others as well. The manner in which we in the United States pursue our inter-

ests is crucial to any effort of the world community to move ahead together in a constructive, cooperative way. What can be expected of the United States in the years ahead? That early patriot, Patrick Henry, once shrewdly observed: "I know of no way of judging the future but by the past." If there are those who doubt our basic intentions and motivations, I commend that standard to you. You will find, I believe, our record to be a proud and constructive one, aimed not at dominance but at mutual growth and strength.

Even before the end of World War II—with the cooperation of many, but primarily with American initiative and support—the foundations of the present monetary system were set out at Bretton Woods. Today, only monetary historians may recall that this approach was not adopted without a struggle. An important segment of American opinion favored the so-called "key currency" approach. Arguing essentially that the economic ascendancy of the United States justified enshrining a kind of informal dollar-sterling standard with other currencies assuming a more or less permanent subsidiary role.

But policy makers embraced another line of thought. It led to the International Monetary Fund (IMF)—a thoroughly multilateral system, with proportional participation and voting by all members.

The same issue was posed—and answered in the long debate over the introduction of special drawing rights. Again, the United States joined enthusiastically in a deliberate decision to seek a broader, multilateral base for reserve creation, building on the mechanism of the IMF.

I recognize, of course, that the monetary system established at Bretton Woods did not abrogate the reality that the United States emerged from World War II as the principal producer of many goods in a war-shattered world. Our allies and former enemies alike lacked the financial resources to buy those goods or rebuild their economies.

Our interests and compassion combined to provide vast resources devoted to reconstruction through the Marshall Plan and otherwise. New trading arrangements were put in place and codified in the General Agreement on Tariffs and Trade.

The competitive recovery of other countries was speeded by a series of large devaluations of other currencies in 1949 and thereafter. We came to acquiesce in restrictive practices by many countries. Investments by our industry overseas were strongly encouraged by our tax and other policies. And, as the need for financial assistance tapered off in Europe, we pioneered in assistance to the developing world. At this point, there was a shortage of, and a cry for, the United States dollar.

I recite this brief record not to elicit either praise or thanks. My point is simple. We have consistently felt through the years that our basic national interest lies in an outward orientation of economic policy—alert and responsive to the needs of others.

Today:

—The United States continues as the major capital exporter;

—We make heavy outlays for defense costs in Europe;

—The aid burden remains large, despite increasing participation by others.

As any nation, it might have been possible for us to redress our payments balance sharply and decisively by turning inward:

—By heavily protecting our markets,

—By sharply cutting our aid, and

—By retreating into a "Fortress America". But we refrained.

Our markets have remained among the most open in the world, in the face of massive increases in imports. We have supported the growth of the Common Market, despite its commercial and economic costs. We led repeated efforts to cut tariffs multilaterally, while continuing to accept the pleas of Japan and the Common Market that major areas of their economies should be shielded from international competition.

I leave it to others to judge whether the policies of the United States for more than the past quarter century have been benign. But I submit they have not been policies of neglect.

We are now dealing with not one but two problems simultaneously in the interest of the monetary system and, more broadly, a liberal trading order.

I refer first to our underlying deficit—running at $2 billion to $3 billion a year.

The second problem is one of enormous short-term money flows. In a sense, it grows out of the success in achieving broad, fluid, and integrated international capital and money markets throughout the free world. But now we see signs that the child of success is threatening the mother that nurtured it—the system of fixed exchange rates and freely convertible currencies.

Neither of these problems is uniquely American. We must all be concerned with the stability of the system, and the stability of the dollar that is a cornerstone of the system—whether we planned it or not and whether we like it or not.

The relevant issue is not to fix blame for how we got where we are—and then engage in destructive recriminations. We need a more constructive approach. Let us fix national responsibilities to deal with the problem now and in the future—responsibilities that can realistically be

met because they are well rooted in present circumstances and present capabilities—not those of the first postwar decade.

Let us, too, identify and undertake those joint actions necessary to deal with short-term flows—without in the process tearing apart the essential fabric of the system and institutions that serve us all.

Our own responsibilities are clear enough. The largest trading nation and custodian of the reserve currency is properly asked to meet high standards of economic performance. Prosperity and price stability are essential ingredients of that performance.

In the late 1950's and early 1960's we did achieve virtual price stability. Our current account reflected the benefits. I fully recognize that in more recent years our record has been a less happy one.

But the fact is that we had the will and the courage during the past 2½ years to bring our inflation under control by stern fiscal and monetary policies. Specifically, we raised taxes, and in 1969 and early 1970 money was tighter and interest rates higher than in any time in the last one hundred years.

The domestic cost has been heavy. Excess demand has given way to economic slack, low profits, and unemployment of five million people, more than the entire labor force of the Netherlands, Belgium, or Switzerland.

Inflation has been slow to yield—but it is yielding. Now tight money and fiscal restraint have been replaced by ease and stimulation. In the circumstances, is this wrong? I think not. Certainly, it would make little sense to ask for high interest rates in the United States at the expense of more unemployment, and at the same time bless higher rates of interest abroad because other nations believe it is in their interest to use that weapon to combat inflation.

Inflation has contributed to the prolongation of our balance-of-payments deficit. But it is far from the only factor.

Specifically, we today spend nearly 9 percent of our gross national product on defense—nearly $5 billion of that overseas, much of it in western Europe and Japan. Financing a military shield is a part of the burden of leadership; the responsibilities cannot and should not be cast off. But twenty-five years after World War II, legitimate questions arise over how the cost of these responsibilities should be allocated among the free world allies who benefit from that shield. The nations of western Europe and Japan are again strong and vigorous, and their capacities to contribute have vastly increased.

I find it an impressive fact, and a depressing fact, that the persistent underlying balance-of-payments deficit which causes such concern, is more than covered, year in and year out, by our net military expenditures abroad, over and above amounts received from foreign military purchases in the United States.

A second area where action is plainly overdue lies in trading arrangements. The comfortable assumption that the United States should—in the broader political interests of the free world—be willing to bear disproportionate economic costs does not fit the facts of today. I do not for a moment call into question the worth of a self-confident, cohesive Common Market, a strong Japan, and a progressing Canada to the peace and prosperity of the free world community.

The question is only—but the only is important—whether those nations, now more than amply supplied with reserves as well as with productive power, should not now be called upon for fresh initiative in opening their markets to the products of others.

Is it natural or inevitable that fully 30 percent of Japanese exports go to the United States market—or do restrictions in Europe help account for the direction of that flow?

After years of income growth averaging more than 10 percent, should not the Japanese consumer have free access to the products of the outside world?

Must Canada maintain tariffs on private purchases of United States autos at a time when a balance-of-payments surplus has resulted in a "floating" exchange rate?

Is it right that United States agricultural products find access to the densely populated continent of Europe increasingly limited?

I would suggest that all of these, and more, are proper matters for negotiation and resolution among us on a more equitable basis.

On the side of financial policy, I think we have all become more aware of the limitations placed on coordinated action by domestic policy requirements. Repeated reference has been made in this conference to the difficulties—with the best will in the world—of synchronizing international monetary and fiscal policies. The hard fact is that the business cycle is not uniform from country to country—indeed, it is perhaps fortunate that it is not.

In these circumstances it is still a dream—a worthy dream to be sure, but no more than that—to achieve a common level of interest rates. There are large disparities today—there have been before—and there will be again. If we are not all to take refuge behind a shield of comprehensive exchange controls or split exchange rates, money will move from nation to nation, and often in larger volume and faster than we would like to see.

Here is a clear and present danger to our monetary system. We must reconcile the stability needed to facili-

tate trade and investment with the flexibility needed to cope with massive flows of funds, actual and potential.

I am convinced the solution cannot be one dimensional. And I will not now attempt to set forth a finished blueprint for a comprehensive approach.

But two lines of attack seem to me both promising and potentially practical. In combination, they could go a long way.

Flexibility is essential. This requires a certain elasticity in financing. Much has been done already on an *ad hoc* basis.

In the present situation the United States has made clear its willingness to help by absorbing some funds from the Euro-dollar market or elsewhere, recycling these funds to the United States before they reach official hands abroad. The recent short-term borrowings of $3 billion by the Treasury and the Export-Import Bank are a case in point. In specific instances, additional dollar investment outlets tailored to the needs of central banks might have a useful subsidiary role. At the same time, we have a right to anticipate that other central banks will not themselves add to the market supply of dollars by contributing to the multiplication of Euro-dollars.

Further exploration of these matters needs, and is receiving, urgent attention. Moreover, in the interest of both equity and financial order, we must ask ourselves whether the Euro-dollar market should be accorded a position free of supervision and regulation which we deny to our domestic banking systems.

Secondly, in the light of recent pressures, the question of codifying a degree of additional flexibility with regard to exchange rate practices is clearly relevant. *De facto* events have brought some elements of flexibility. But I doubt that any of us could be satisfied with the variety of responses to the imperatives of speculative pressures.

The danger is plain. To revert to the use of exchange rates as a supplementary tool of domestic policy is fraught with danger to the essential stability and sustainability of the system as a whole.

As time and events change, we must respond with a recognition of mutual needs and confidence. We all recognize there is no more room for monetary or economic isolation.

It is to our mutual interest to work out the world's monetary problems, so that trade and commerce may expand and thus support national needs.

Helpful to the solution of any problem is the understanding that there are necessarily some unalterable positions of any participant. Believing this, I want without arrogance or defiance to make it abundantly clear that the Nixon Administration is dedicated to assuring the integrity, and maintaining the strength, of the dollar.

We are not going to devalue.

We are not going to change the price of gold.

We are controlling our inflation. We also are stimulating economic growth at a pace which will not begin new inflation.

So far as other nations are concerned: We fully recognize you are not willing to live with a system dictated by the United States.

But, as you share in the system, we have the right to expect more equitable trading arrangements.

We also expect you to accept the responsibility to share more fully in the cost of defending the free world.

Finally:

No longer does the United States economy dominate the free world. No longer can considerations of friendship, or need, or capacity justify the United States carrying so heavy a share of the common burdens.

And, to be perfectly frank, no longer will the American people permit their government to engage in international actions in which the true long-run interests of the United States are not just as clearly recognized as those of the nations with which we deal.

And it is with this understanding that I say to you that increased cooperation among us all must play a key role in maintaining a stable monetary system.

You can be assured that we will do our part.