THE CHANCE OF PROSPERITY

A series of three articles by A. J. CARTER

3. EXCHANGE RATES, TRADE AND THE EEC

'The relationship between the economies of different countries cannot remain static and a scheme of fixed exchange rates is obsolescent the moment it is adopted."

ONE of the apparent drawbacks of following a policy of economic growth is that it would lead to a rise in imports and a strain on the balance of payments. In a time of slow liberalization of world trade, governments have been reluctant to act directly on imports, and prior to the devaluation of sterling in 1967 the usual method of restraining imports was by damping down overall demand. This was bad for growth and investment, a self-inflicted injury at once crude and painful. It was also fashionable to restrict overseas investment (which would have yielded a return), and to borrow wherever we could. This was all necessary, we were solemnly told, to preserve the integrity of the pound whose value we must defend like the frontiers of Britain itself.

These measures were the pitiful response to pressure on the exchange rate arising from the severe balance of payments deficit. The underlying cause of the deficit was an adverse balance of "visible" trade—imports and exports of goods—combined with a level of government spending overseas which more than offset the private surplus of "invisible" items such as banking and insurance. The vulnerability of sterling as an international currency aggravated this weakness and precipitated the crisis. Holders of sterling, afraid of devaluation, began to unload their pounds and so helped to bring it about.

Government spending overseas has now been reduced, and as a result of the devaluation Britain is exporting more goods than she is importing and for the time being is enjoying a large balance of payments surplus. This is being used partly to augment our reserves of foreign currency but mainly to repay our debts. It is to be hoped that the surplus will last long enough to clear them all for devaluation is not a long-term answer!

A balance of payments is an excess or shortage of foreign currency—really, an imbalance of payments. It arises because the supply of foreign currency is out of line with the demand for it. As long as countries go on fixing their exchange rates there will always be balance of payments problems, both surpluses and deficits. The relationship between the economies of different countries cannot remain static and a scheme of fixed exchange rates is obsolescent the moment it is adopted. The only way in which balance of payments troubles can be eliminated is by maintaining freely floating exchange rates so that the supply of and demand for foreign currency is adjusted by the movement in its price.

It is normally in a country's interest for the price of its currency to be as high as possible in the foreign exchange markets. The more foreign currency that people will offer for each pound the more foreign goods we can buy with our pound and the higher is our standard of living. With a floating exchange rate the price of the pound, like the price of tomatoes, finds its own level. The more efficient production and the less inflation there is in Britain compared with that in other countries, the higher the pound will stand, but it must not be supported artificially, with all the evils that this can lead to.

There will no doubt still be an initial increase in imports if there is a burst of growth with a floating rate, but the effect of this will be not a threat to the balance of payments but a fall in the value of the pound which would make imports dearer and the cost of exports keener. A new equilibrium would be established, and as the economy continued to expand and imported raw materials were turned into manufactured goods for export the rate could be expected to rise. There would be no call for the government to check the expansion just as it was getting under way, and the new-found consistency in government policy would of itself improve confidence and therefore investment and productivity.

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Britain's economy is part of a world economy, the parts of which are interdependent and would become more so were it not for the political obstacles that are put in the way. Britain's raw materials come from many countries, and to break the barrier to production existing in Britain itself is only the first step. The ideal is for the natural resources of the world to be available to the whole of mankind. Only then will the ultimate barrier to production be fully destroyed and the problems of the world that now overwhelm us become capable of solution.

That is a vision of a future which is sadly remote, but there is a more immediate goal internationally and that is the freeing of trade. There is a fascinating economic theory—the theory of comparative costs—which proves that trade between two countries is good for both, even if one is more efficient than the other at everything!

Trade arises because of the varying natural advantages of different areas and the benefits of the division of labour; it is undertaken because both parties gain an advantage from it. Economically, international trade is

merely trade in which one party happens to live in a different country from the other. It is only politically that it becomes something to be encouraged or discouraged, controlled or decontrolled, regulated for the enrichment of whatever industry has the ear of the national government and can beg persuasively for help.

To secure the most efficient use of resources trade as well as production must be free, both internally and internationally. There must be an end to privileged monopolies, subsidies, tariffs and quotas, and any other practices restricting open competition, all of which divert resources away from their most profitable uses.

The current movement towards freer international trade is welcome, but it is in danger, not only from a resurgence of protectionism, but, more subtly, from the magnetism of trading blocs.

One such bloc is the European Economic Community, of which Britain seems likely to become a member in January 1973. Whether joining the Community will prove a grand opportunity or an unmitigated disaster, or neither of these two things, we shall probably not know for another decade, but as a step towards freer international trade it is certainly suspect. The abolition of tariff barriers between the countries of the Common Market is fine, but all the member countries have to accept a common external tariff and so lose the power to reduce tariffs unilaterally. The trend towards liberalization of world trade should in theory include the Common Market, but it is clear from other Common Market arrangements, particularly the common agricultural policy, that the motive behind the formation of the Community is not the freeing of production and trade from restrictions but the expansion of a protected home market. Britain within a larger protected home market may be better off than a protectionist Britain alone, but better than either of these alternatives would be a Britain pioneering free trade.

However, the present government, like others before it, looks on membership of the Common Market as an answer to many of Britain's problems. The member countries' higher rate of economic growth and higher level of real wages are cited as reasons for Britain's joining, and so they may be, if it can be demonstrated that they would not have happened anyway, without the Common Market, and if there are not major differences between Britain's position now and that of the other countries when they joined. Against this, there are definite costs: a burden on the balance of payments (which with a free exchange rate would be translated into higher prices for imports) and increases in the price of food. Ever since the repeal of the Corn Laws in 1846 Britain has imported food from the cheapest quarter and it is retrograde to introduce import levies now, even if we have supported our own farmers by other means.

Politically, Britain would risk some deterioration in her relationship with the Commonwealth but would share in the aim of the Common Market to foster European co-operation and unity and increase the influence of Europe in the world. Co-operation between the countries of Europe could probably be achieved without the need for any pooling of sovereignty, but there was something deeper envisaged by those who framed the Treaty of Rome, namely, a gradual evolution towards European integration. This would seem on the whole to be a worth-while objective.

As to the influence of Europe in the world, it all depends how wise that influence is, and this is the crux of the whole Common Market debate. Will the Community use its influence only to enhance itself, to further its own interests and enrich its own members, or will it try to extend its prosperity and success to the countries outside itself? Will it, to use the jargon, be inward-looking or outward-looking?

There is a case for Britain joining the Common Market and there is a case against it. Quantifiable disadvantages have to be weighed against unquantifiable opportunities, economic facts against political judgements, and the situation now against what may be reasonably hoped for in the future. To bankrupt thinkers Britain's membership of the Common Market may appear as a way of breaking our economic deadlock, but the economic consequences of entry, though appreciable, cannot be fundamental. Joining the Common Market offers no golden escape route from Britain's economic problems, which must be tackled at the roots whether we are part of the European Economic Community or not.

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What is needed to restore Britain's economy to its full vigour is an atmosphere in which the economy can grow, free from the disease of inflation and the constraints of the balance of payments, with the barrier between land and labour removed, with resources put to their maximum use unhindered by repressive taxation or other interference with production and trade, and with full employment assured as the natural accompaniment of expansion. There is no reason why this cannot be achieved and the British people look forward to genuine prosperity instead of an uncertain and precarious affluence or in many cases outright poverty.

The opportunity is there. If the muddled thinking could be dispelled and new initiatives taken boldly and confidently, the rewards would be great, and Britain could again stand as an example to the rest of the world.