CHAPTER 3

The United States in the World Economy: Strains on the System

DURING THE 1970s the world's market economies became more integrated with each other than ever before. Exports and imports as a share of gross national product (GNP) reached record levels for most industrial countries, while international lending and direct foreign investment grew even faster than world trade. This closer linkage of economies was mutually beneficial. It allowed producers in each country to take greater advantage of their country's special resources and knowledge, and to take advantage of economies of scale. At the same time, it allowed each country to consume a wider variety of products, at lower costs, than it could produce itself.

Underlying the growth in world trade and investment was a progressive reduction of barriers to trade. The postwar period was marked by a series of agreements to liberalize trade: both multilateral, like the Kennedy Round, and bilateral, like the Canada-U.S. auto pact.

In spite of its huge benefits, however, this liberalized trading system is now in serious danger. Within the United States, demands for protection against imports and for export subsidies have grown as a combination of structural changes, sectoral problems, and short-run macroeconomic developments has led to a perception that we are becoming uncompetitive in world markets. In Europe, a growing structural unemployment problem, aggravated by the recession, has increased protectionist pressures. In the developing countries a financial crisis threatens the integration of capital markets and is pushing many countries back toward the exchange controls and import restrictions they had begun to dismantle.

These problems must not be allowed to disrupt world trade. If the system comes apart—if the world's nations allow themselves to be caught up in a spiral of retaliatory trade restrictions—a long time may pass before the pieces are put back together.

This chapter reviews the strains on the international economic system and the policies by which the United States is attempting to overcome them. It is divided into four sections. The first section discusses long-term changes in U.S. competitiveness. The correction of
widespread misconceptions about the competitive position of the United States is essential if we are to get through the difficult period ahead without making major policy mistakes. The second section of the chapter is devoted to financial developments and their effects on trade, especially the appreciation of the dollar and its likely effects on the U.S. trade balance. Two final sections examine macroeconomic and financial problems in Europe and the developing countries.

LONG-RUN TRENDS IN U.S. COMPETITIVENESS: PERCEPTIONS AND REALITIES

Concern over the international competitiveness of the United States is as high as it has ever been. It is argued with increasing frequency that U.S. business has steadily lost ground in the international marketplace. This alleged poor performance is often attributed both to failures of management in the United States and to the support given to foreign businesses by their home governments. Feeding the perception of declining competitiveness is the persistent U.S. deficit in merchandise trade, especially the imbalance in trade with Japan.

Changes in U.S. trade performance must, however, be put into the context of changes in the U.S. role in the world economy. This wider approach reveals that much of the concern about long-run competitiveness is based on misperceptions. Although the recent appreciation of the dollar has created a temporary loss of competitiveness, the United States has not experienced a persistent loss of ability to sell its products on international markets; in fact, in the 1970s the United States held its own in terms of output, exports, and employment. Changes in the relationship of the United States to the world economy, however, have made the United States look less competitive by some traditional measures.

AGGREGATE PERFORMANCE OF THE UNITED STATES AND OTHER DEVELOPED COUNTRIES

Discussion of U.S. competitiveness often gives the misleading impression that the United States has consistently performed poorly relative to other industrial countries. The U.S. share of world trade and world GNP did in fact decline throughout the 1950s and 1960s, reflecting the recovery of the rest of the world from World War II, together with the narrowing of the huge and unsustainable U.S. technological lead. In the 1970s, however, this long decline leveled off.

- From 1973 to 1980, real gross domestic product (GDP) in the United States grew at an annual rate of 2.3 percent, compared...
with 2.6 percent in the other Organization for Economic Coop-
eration and Development (OECD) countries.

- From 1973 to 1980 the U.S. share of OECD exports remained
  nearly constant, declining from 17.6 to 17.2 percent.

- Over the same period, employment in the United States grew at
  2.1 percent a year, compared with only 0.5 percent in the rest of
  the OECD countries.

The United States, in part as a side effect of its relatively rapid
growth in employment, did do poorly by comparison in one respect,
productivity growth. Output per worker grew at only 0.2 percent in
the United States, compared with 2.2 percent a year in the rest of the
OECD countries. Productivity is, of course, crucial to living stand-
ards; ultimately, the level of consumption per capita depends on the
level of output per worker. But there is no necessary relation be-
tween productivity and competition in international markets. Slow
growth in productivity only hampers a country's international com-
petitiveness if it is not offset by correspondingly slow growth in real
wages. If U.S. workers, for example, were to receive real wage in-
creases equal to those granted in other countries while their produc-
tivity failed to increase at a comparable rate, U.S. industry would find
itself increasingly uncompetitive. The fact is, however, that this did
not occur, as the comparative experience of the United States and
the European Economic Community illustrates. From 1973 to 1980
output per manufacturing worker in the European Economic Com-
munity rose at an annual rate of 2.7 percent, but real compensation
rose at an annual rate of 4.1 percent. By contrast, output per worker
in the United States rose 1.1 percent annually, while real compensa-
tion rose only 1.8 percent annually. In fact, until the recent rise in
the dollar's exchange rate, it was workers in the European Economic
Community, rather than those in the United States, who were prob-
ably pricing themselves out of the world market in spite of their rela-
tively good productivity performance.

The overall performance of the United States, then, does not sug-
gest a long-term problem of competitiveness. The shift from persist-
ent trade surplus to persistent deficit which occurred over the last
decade is, however, often misinterpreted as a sign of an inability to
compete. In fact, changes in the structure of the U.S. balance of pay-
ments are more the result of changes in the U.S. saving and invest-
ment position than of slow productivity growth.

THE CHANGING STRUCTURE OF THE U.S. BALANCE OF PAYMENTS

In the 1950s and early 1960s the United States normally had a
trade surplus and invested heavily in other countries. In the years
after 1973, however, the United States normally had a trade deficit,
and annual investment by foreigners in the United States began to approach annual U.S. investment abroad. The shift in the U.S. trade balance was closely connected with the shift in investment flows.

Taken as a whole, U.S. international transactions always balance. Any force tending to increase or decrease the balance in one category of transactions sets in motion a process leading to exactly offsetting changes in balances in other categories. For example, an increase in foreign demand for U.S. exports tends directly to improve the trade balance, but this improvement leads to a rise in the dollar's exchange rate against foreign currencies. The exchange-rate appreciation in turn leads to increases in imports, a worsened balance on services, and so on. Similarly, an increased desire by foreign residents to invest in the United States is reflected in an increase in the capital account but leads to an appreciation of the dollar and an offsetting decline in other parts of the balance of payments.

The shift in the U.S. trade balance from persistent surplus to persistent deficit was largely an offset to changes in the U.S. capital account. In the 1950s and the first half of the 1960s, rates of return on capital were lower and wage rates were higher in the United States than in other industrial countries. Since the United States suffered no war damage, its capital stock was intact, and the diffusion of U.S. technology abroad created a demand for new capital investment in the recipient countries. The result was that returns to investment were higher abroad than in the United States, and the United States was a heavy net foreign investor. The counterpart to this foreign investment was a persistent surplus on current transactions, including merchandise trade.

By the 1970s the other industrial countries had narrowed or eliminated these differences in capital and labor costs. The result was that the demand for new capital abroad was no longer a great deal larger than it was in the United States. At the same time, the supply of savings in the United States was restricted by a low national saving rate (the lowest among the major industrial countries). Thus the United States ceased to be a major net exporter of capital, and the current account of the balance of payments moved from surplus to rough balance. Meanwhile, the U.S. balance on items other than merchandise trade improved: the deficit in military transactions fell, the surplus in services rose, and, in particular, the accumulation of past foreign investments began to yield increasing income. This meant that a balanced current account was associated with a deficit in merchandise trade.

Table 3–1 and Chart 3–1 show how the structure of the U.S. current account has changed, measuring its components as percentages of GNP.
<table>
<thead>
<tr>
<th>Type of balance</th>
<th>Percent of GNP 1960-66</th>
<th>Percent of GNP 1974-80</th>
<th>Change, percentage points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchandise trade</td>
<td>0.86</td>
<td>-0.80</td>
<td>-1.66</td>
</tr>
<tr>
<td>Investment income</td>
<td>0.74</td>
<td>1.06</td>
<td>.32</td>
</tr>
<tr>
<td>Military transactions</td>
<td>-.41</td>
<td>-.03</td>
<td>.38</td>
</tr>
<tr>
<td>Travel and services</td>
<td>-.04</td>
<td>.12</td>
<td>.16</td>
</tr>
<tr>
<td>Remittances</td>
<td>-.44</td>
<td>-.30</td>
<td>.15</td>
</tr>
<tr>
<td>Current account</td>
<td>.70</td>
<td>.06</td>
<td>-.64</td>
</tr>
</tbody>
</table>

Source: Department of Commerce, Bureau of Economic Analysis.

Chart 3-1

**Structural Changes in the Current Account Balance**

PERCENT OF GROSS NATIONAL PRODUCT

Note.—Data are 16-quarter weighted centered moving averages.
Source: Department of Commerce.
THE ISSUE OF U.S. TRADE WITH JAPAN

The perception of diminished U.S. competitiveness stems not only from the U.S. trade deficit but from an impression that U.S. trade performance compares poorly with that of other countries, especially that of Japan. Japan runs a huge surplus in its manufactures trade, while the United States runs only a small one, and Japan also has a large surplus in its bilateral trade with the United States. These facts are often attributed to Japanese trade restrictions. Japan does maintain restrictions which seriously hurt U.S. businesses. Trade restrictions, however, do not in the long run improve the Japanese trade balance; as discussed more fully below, they lead to offsetting increases in other imports or declines in exports. The main explanation of Japan’s surplus in manufactures trade and in trade with the United States is that Japan, with few natural resources, incurs huge deficits in its trade in primary products, especially oil, and with primary producers, especially the Organization of Petroleum Exporting Countries (OPEC). The surpluses in the rest of Japan’s trade offset these deficits.

Table 3-2 and Chart 3-2 show the differences in the structure of the Japanese, European, and U.S. trade accounts. They show clearly how the huge Japanese surplus in manufactures offsets large deficits in primary products.

Corresponding to the Japanese sectoral deficit in primary products, especially oil, is a regional deficit with OPEC. Japan makes up for its deficit with OPEC by running surpluses in its trade with other regions. The extent of this regional imbalance—and its contrast with the U.S. position—is shown in Table 3-3. The point here is similar to that already made with respect to the overall U.S. trade balance: looking at Japanese-U.S. trade in isolation is misleading. The Japanese surplus in trade with the United States is largely a response to the rise of OPEC.

Although Japanese trade policy does not play a central role in causing the bilateral trade imbalance with the United States, Japanese import restrictions remain a major source of friction. Japan maintains a variety of nontariff barriers against imports. These include import quotas for a number of agricultural products and “red tape” barriers against manufactured goods, such as stringent inspection requirements applied against imported goods but not against Japanese products. These trade restrictions probably do not lead to a larger overall Japanese trade surplus. If they were removed, the yen would depreciate and increased Japanese imports in the currently protected sectors would be offset by reduced deficits or increased surpluses elsewhere. Japanese trade restrictions do, however, distort the composition of U.S. trade with Japan, imposing serious costs on some U.S. produc-
TABLE 3-2.—Trade balances by commodity group as percent of GDP, United States, Japan, and the European Economic Community, 1980

(Percent of GDP)

<table>
<thead>
<tr>
<th>Commodity group</th>
<th>United States</th>
<th>Japan</th>
<th>European Economic Community</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>-1.45</td>
<td>-0.99</td>
<td>-2.23</td>
</tr>
<tr>
<td>Primary products</td>
<td>-1.93</td>
<td>-1.11</td>
<td>-5.41</td>
</tr>
<tr>
<td>Food, beverages, and tobacco</td>
<td>.40</td>
<td>-1.26</td>
<td>-4.1</td>
</tr>
<tr>
<td>Crude materials excluding petroleum</td>
<td>.54</td>
<td>-2.15</td>
<td>-1.23</td>
</tr>
<tr>
<td>Mineral fuels</td>
<td>-2.87</td>
<td>-6.71</td>
<td>-3.77</td>
</tr>
<tr>
<td>Manufactures</td>
<td>.48</td>
<td>9.12</td>
<td>3.18</td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td>-.42</td>
<td>3.09</td>
<td>.88</td>
</tr>
<tr>
<td>Other manufactured goods</td>
<td>.90</td>
<td>6.02</td>
<td>2.30</td>
</tr>
</tbody>
</table>

Source: Organization for Economic Cooperation and Development.

Chart 3-2

Composition of Trade, 1980

PERCENT OF GROSS DOMESTIC PRODUCT

[Bar chart showing composition of trade for United States, European Economic Community, and Japan in 1980.]

Source: Organization for Economic Cooperation and Development.
ers. As the fastest growing and second largest market economy, Japan has a responsibility to help sustain the open trading system. A major trade liberalization by Japan would do much to relieve the political strains on that system, while the failure of Japan to make more than token concessions would intensify them.

Table 3-3.—Trade balances by region as percent of GDP, United States and Japan, 1980

<table>
<thead>
<tr>
<th>Region</th>
<th>United States</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial countries</td>
<td>0.23</td>
<td>1.92</td>
</tr>
<tr>
<td>Oil-exporting countries</td>
<td>-1.45</td>
<td>-3.20</td>
</tr>
<tr>
<td>Non-oil developing countries</td>
<td>0.52</td>
<td>1.46</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund.

The Problem of Uncompetitive Sectors

Analysis of the overall U.S. trade deficit and the bilateral deficit with Japan suggests that worries about U.S. competitiveness are based in part on a misunderstanding of the situation. There is no question, however, that increased foreign competition has forced some sectors of the U.S. economy to contract.

This is partly a consequence of the fact that trade has become more important to the U.S. economy. Specialization by nations is the reason for international trade. If the United States is to expand its trade, the U.S. economy must become more specialized. This means that some sectors will grow and others will shrink. During the 1970s the United States developed increasing surpluses in areas in which it already enjoyed a comparative advantage and developed increasing deficits in sectors in which it was at a disadvantage. Some illustrative numbers are given in Table 3-4.

Table 3-4.—U.S. trade balances by sector as percent of GDP, 1972-79

<table>
<thead>
<tr>
<th>Item</th>
<th>1972</th>
<th>1979</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. comparative advantage:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research-intensive manufactures</td>
<td>0.93</td>
<td>1.63</td>
</tr>
<tr>
<td>Resource-intensive products, other than fuels</td>
<td>0.06</td>
<td>0.67</td>
</tr>
<tr>
<td>Invisibles (services and investment income)</td>
<td>0.40</td>
<td>1.44</td>
</tr>
<tr>
<td>U.S. comparative disadvantage:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nonresearch-intensive manufactures</td>
<td>-1.27</td>
<td>-1.44</td>
</tr>
<tr>
<td>Fuels</td>
<td>-2.27</td>
<td>-2.41</td>
</tr>
</tbody>
</table>

Sources: International Monetary Fund, National Science Board, and Organization for Economic Cooperation and Development.

Specialization of this kind is desirable both for the United States and for its trading partners. Specialization and trade raise the efficiency of the world economy as a whole by allowing each country to
concentrate on doing what it does relatively well, and by allowing increased economies of scale. But greater specialization can leave those involved in the contracting sectors worse off, at least temporarily. Attempts to prevent adjustment through trade barriers or subsidies, however, impose severe costs on unprotected sectors.

Some sectoral reallocation of resources, then, is a normal consequence of the increasing U.S. integration into the world economy. This is not the whole story, however. Some sectors of the U.S. economy are confronted by a problem that is not simply the result of market forces. Broadly speaking, these sectors fall into two groups. In one group are sectors where firms or their workers, accustomed to having substantial market power, now find that they have priced themselves out of the world market. In the other group are sectors which are hurt by foreign protectionism or export subsidies.

Market Power and Competitiveness

The "problem" of diminished market power in some sectors actually derives from a desirable aspect of trade: the fact that trade increases competition. One of the major benefits of an increasingly open U.S. economy is that it reduces the problems of monopoly and market power, thus increasing efficiency and helping consumers. But the transition to more competitive markets can prove painful. When an industry accustomed to having domestic market power encounters international competition, it must accept a reduction in the premium in prices and wages it previously commanded over other sectors of the economy. Both firms and workers may be reluctant to accept this implication of increased competition, and idle capacity and unemployment may result. Prices and wages in some U.S. heavy industries are probably too high to be sustainable in an integrated world economy.

Policies of Foreign Governments

A different problem is posed when foreign governments engage in protective or export promotion measures that harm U.S. producers. U.S. trade negotiators have emphasized four particular areas of concern:

1. Agriculture: Japan and the European Economic Community have high protective barriers against U.S. agricultural products. Further, the European Economic Community now engages in massive subsidized export of agricultural products to dispose of the surpluses created by its price-support program. These measures depress world prices of agricultural products, imposing substantial costs on U.S. producers in a sector where the United States holds a clear comparative advantage.
2. **High technology:** In recent years, many countries have come to view the high-technology industries as vehicles for economic growth and have sought to promote them through a complex mix of policies—outright subsidies, export credit subsidies, research subsidies, preferential procurement by State-owned enterprises, and so on. The United States holds a comparative advantage in high-technology products, and the U.S. export market share has remained roughly constant since 1973. Nevertheless, there is concern that in some specific areas, especially aircraft, foreign subsidies are threatening the position of U.S. producers.

3. **Services:** The United States has developed an increasingly strong net export position in services. Services, however, have never been recognized as being under the rules of the international trading system, and trade in services is limited by a maze of foreign government regulations.

4. **Investment:** Many countries impose “investment performance requirements” on foreign investors in exchange for the right to invest or to receive investment incentives. Many of those performance requirements are trade-related, requiring foreign companies to export more, reach a specified level of local content, or reduce imports.

**CHALLENGES TO U.S. TRADE POLICY**

The next few years are critical for the international trading system. Accumulating structural problems have combined with short-run macroeconomic stresses to produce a resurgence of protectionist pressures. The Administration’s aim, nonetheless, is to preserve and extend the benefits of freer trade. To do this will require resisting protectionist pressures at home while continuing to urge foreign governments to eliminate their more objectionable trade-distorting policies.

**Responding to Foreign Actions**

The practices of foreign governments pose extremely difficult issues for U.S. trade policy. The United States customarily seeks to induce other nations to move in the direction of freer trade. The dilemma is how to do this without imposing costs on ourselves that exceed the benefits from changes in other countries’ policies.

Trade-distorting measures, whether they take the form of protection against imports or the promotion of exports, hurt the country which adopts them as well as other countries, even when they are a response to foreign trade-distorting practices. If foreign governments limit imports from the United States and we respond in kind, the initial results will be further reductions in economic efficiency at home and higher domestic prices. If foreign governments subsidize exports, depressing world prices for U.S. products, a countersubsidy by
the United States will depress prices still further. The belief that departures from free trade are automatically called for if other countries do not play by the rules is a fallacy.

Intervention in international trade by the U.S. Government, even though costly to the U.S. economy in the short run, may, however, be justified if it serves the strategic purpose of increasing the cost of interventionist policies by foreign governments. Thus, there is a potential role for carefully targeted measures, explicitly temporary, aimed at convincing other countries to reduce their trade distortions.

There are obvious risks in such a course of action. Instead of inducing other countries to move toward freer trade, U.S. pressure might set off a cycle of retaliation which would leave everyone worse off. There are also domestic political risks. Trade measures intended to be temporary may end up permanent and institutionalized. The need to balance the strategic objective of reducing foreign trade barriers against the harm which might be caused by U.S. retaliatory measures explains the U.S. policy of negotiating for freer trade while holding open the possibility of more direct action as a last resort.

**Responding to Problem Industries**

The problems of industries which have recently lost their traditional market power also pose a serious policy dilemma. There is strong pressure to give these industries at least temporary relief from imports, in the hope that lower wage and price increases and improved productivity will eventually make them competitive again. On the other hand, protection reduces the incentives for both firms and workers to make these changes. Furthermore, protectionist measures, however temporary they are supposed to be, tend to become permanent. The limitation of protection for these problem industries is a central goal of U.S. economic policy.

**EXCHANGE RATES AND THE BALANCE OF PAYMENTS**

During 1982 the dollar rose against other major currencies to its highest level since the beginning of floating exchange rates in 1973. The strength of the dollar provided some benefits to the U.S. economy by reducing import prices and thus accelerating progress against inflation. On the other hand, the strong dollar caused severe problems by decreasing the cost competitiveness of exported U.S. goods.

**CAUSES OF THE DOLLAR'S STRENGTH**

Exchange-rate movements are not well understood. Econometric models of exchange-rate determination proposed in the past decade have not shown any consistent ability to track past exchange-rate movements, let alone predict future changes. Nevertheless, careful
analysis can narrow the range of plausible explanations of the dollar's rise.

The recent appreciation of the dollar, unlike many earlier exchange-rate movements, did not simply reflect contemporaneous changes in relative price levels. The well-known theory of purchasing power parity suggests that the rate of change in the exchange rate should equal the difference between the foreign and domestic inflation rates. Over the very long run, or in situations of very large differences in inflation rates, the purchasing power parity theory has proved to be a useful guide. But the theory has little or no power to explain the recent rise of the dollar. Price increases over the past 2 years in Germany and Japan, for instance, were lower than in the United States. Yet the dollar appreciated dramatically during that period against both the mark and the yen. Stated differently, the rise of the dollar was not simply a nominal but also a real appreciation, as illustrated in Chart 3-3.

Large exchange-rate movements may also occur because of shifts in world demand for a country's exports or changes in a country's demand for imports. An example of such an event was Great Britain's discovery of oil in the North Sea, which has played at least some role in the high level of Great Britain's real exchange rate relative to other European currencies.

No comparable event accounts for the appreciation of the dollar, although U.S. oil imports have declined sharply. The rise of the dollar was not initially accompanied by a deterioration of the trade balance, a fact which might seem to suggest that there was an increase in demand for U.S. goods. The initial lack of deterioration, however, stemmed from lags in the effect of the exchange rate on the trade balance rather than from a shift in either export or import demand, and the U.S. trade deficit grew rapidly in the second half of 1982.

What the rise of the dollar seems clearly to reflect is a rise not in the demand for U.S. goods, but in the demand for U.S. assets. The reasons for the increased attractiveness of investment in the United States are somewhat controversial, but the effects are not. In order to buy U.S. assets, foreigners must first acquire dollars. The increased demand for dollars drives up the exchange rate.

One important factor in the increased demand for U.S. assets was that real interest rates in the United States were high relative to real interest rates elsewhere. Real interest rates are not directly measurable, since they equal the nominal rate minus expected inflation. But some rough measure is attainable by computing the nominal rate minus actual inflation. Chart 3-4 shows the differential in real interest rates computed in this way between the United States and other
industrial countries. The chart suggests that the real interest rate in the United States was substantially higher than foreign rates in recent years.

But events in the fall of 1982 cast some doubt on whether real interest rates alone can explain the dollar’s strength. As U.S. short-term interest rates fell sharply, the differential between short-term interest rates in the United States and other countries was greatly reduced. Yet the dollar continued to rise. The explanation for this may lie in the difference between short- and long-term rates. Most exchange-rate models suggest that long-term real rates, and not short-term ones, are what affect the real exchange rate. A notable feature of the U.S. financial scene in the fall of 1982 was that long-term rates
did not fall nearly as much as short-term rates. At the same time, long-run inflation expectations may have declined, so that it is unclear how much long-term real interest rates actually fell.

Many observers believe that other factors besides real interest rates help explain the dollar's strength. In particular, the unsettled state of the world economy—particularly the problems in Europe and Latin America described later in this chapter—may have created a desire on the part of investors for a safe haven for their funds. The United States, according to this argument, is still regarded as the most politically and economically stable of the market economies and has become a financial refuge in troubled times. While the importance of this factor is hard to assess, the worldwide search for financial security may partially explain this country's rising capital account surplus and its growing current account deficit.
AN UNDERVALUED YEN?

The explanations of the strong dollar discussed so far leave out a view which has received considerable attention—that the strength of the dollar reflects deliberate undervaluation of their currencies by our competitors, especially Japan. This view is important enough in its implications for U.S. international economic policy to deserve separate treatment.

Arguments that the yen is undervalued are of two types, which are basically independent of one another. One argument is that the Japanese government has persistently kept the yen undervalued. The other is that the Japanese have only recently engineered a decline in the yen to gain competitive advantage. Neither of these views appears correct in light of the actual behavior of Japan's balance of payments and exchange rate.

If the first allegation—that the yen has been persistently undervalued—was correct, Japan would run persistent current account surpluses in excess of what seems justified. We would also expect Japan to have experienced exceptionally rapid growth in its foreign exchange reserves. Neither of these was the case:

- From the beginning of floating exchange rates in 1973 through 1981, Japan had an average surplus in its current account of only 0.15 percent of GNP. This was not much more than the U.S. figure for the same period (0.11 percent), considerably less than that of Germany (0.47 percent), and much less than the U.S. surplus of the early 1960s (0.70 percent).
- From the beginning of floating exchange rates in 1973 to the third quarter of 1982, Japan's reserves minus gold grew at an annual rate of 4.8 percent, far less than the 9.7 percent rate of reserve growth for all non-OPEC countries.

These facts contradict the view that the yen was persistently undervalued. There remains the possibility that the yen's weakness during much of 1982 was excessive in some sense. A natural question is whether, after adjustment for purchasing power parity, the yen fell more against the dollar than other currencies. The answer to this question depends on the base period used for comparison. For most base periods, however, the real depreciation of the yen against the dollar appears smaller than that of the French franc and the German mark. Table 3–5 shows an illustrative set of numbers. As the table shows, only for a few base periods does the yen appear more “undervalued” than the other two currencies.

The actual behavior of the Japanese balance of payments and exchange rate thus do not support the view that there is any special undervaluation of the yen—that is, they suggest that exchange-rate
TABLE 3-5.—Real appreciation of the dollar against major currencies to August 1982

<table>
<thead>
<tr>
<th>Base year</th>
<th>French franc</th>
<th>German mark</th>
<th>Japanese yen</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>-1.0</td>
<td>-2.1</td>
<td>-25.3</td>
</tr>
<tr>
<td>1972</td>
<td>11.8</td>
<td>9.5</td>
<td>-13.1</td>
</tr>
<tr>
<td>1973</td>
<td>27.9</td>
<td>31.4</td>
<td>2.0</td>
</tr>
<tr>
<td>1974</td>
<td>21.4</td>
<td>31.0</td>
<td>6.4</td>
</tr>
<tr>
<td>1975</td>
<td>39.5</td>
<td>33.7</td>
<td>7.3</td>
</tr>
<tr>
<td>1976</td>
<td>29.6</td>
<td>28.8</td>
<td>10.9</td>
</tr>
<tr>
<td>1977</td>
<td>29.4</td>
<td>35.9</td>
<td>24.3</td>
</tr>
<tr>
<td>1978</td>
<td>43.0</td>
<td>50.1</td>
<td>53.1</td>
</tr>
<tr>
<td>1979</td>
<td>50.8</td>
<td>53.8</td>
<td>36.8</td>
</tr>
<tr>
<td>1980</td>
<td>51.6</td>
<td>44.2</td>
<td>25.9</td>
</tr>
<tr>
<td>1981</td>
<td>21.1</td>
<td>11.3</td>
<td>22.9</td>
</tr>
</tbody>
</table>

*Percent change in the price of the dollar in each currency, adjusted for differences in consumer price inflation.
*Indicates a base year relative to which the August 1982 exchange rate of the yen looks lower than that of the other currencies.

Source: Board of Governors of the Federal Reserve System.

Movements over the last several years stemmed from a strong dollar rather than a weak yen. An examination of Japanese policy by the U.S. Treasury supports this conclusion. This study found that Japan has attempted to isolate its domestic capital market from world capital markets, but that this has tended to limit capital outflow rather than inflow, supporting rather than weakening the yen. Japanese capital controls have been relaxed in recent years, a move which the United States supports even though the result will be a weaker yen and an increase in Japan’s current account surplus. In the 1980s, Japan may well become more of a capital exporter than it was in the 1970s, and thus have larger current account surpluses. These surpluses, if they materialize, will result from Japan’s high domestic saving rate, which gives Japan a natural role as an exporter of capital to the rest of the world.

To show that there is no special yen issue is not to deny that a substantial deterioration has occurred in the relative cost position of U.S. firms. This deterioration was actually larger relative to other industrial countries, but since Japan is the United States’ most important competitor, the depreciation of the yen worries U.S. firms more. There is no special yen issue, but the strong dollar does pose genuine problems.

EFFECTS OF A STRONG DOLLAR ON U.S. TRADE

The rise of the dollar was associated with a large rise in the production costs of U.S. firms relative to those of foreign competitors. To take one measure, unit labor costs in U.S. manufacturing rose 32 percent relative to those of a weighted average of other industrial countries from their low point in the third quarter of 1980 to the second quarter of 1982. This rise in relative costs has at least tempo-
rarily reduced the international competitiveness of U.S. industry dra-
matically. Other U.S. exporting and import-competing sectors, espe-
cially agriculture, have also been squeezed.

Despite this deterioration in competitive position, it was only in the 
third quarter of 1982 that the U.S. trade deficit began to show a sig-
nificant increase. This delay was in line with previous experience of 
the effect of exchange rates on trade. The full effect of changes in 
exchange rates on the volume of exports and imports is felt only 
after some time has passed, because some trade takes place under 
contracts signed in advance and because customers do not always 
change suppliers immediately when relative prices change. The short-
term effect of a rise in the dollar is to reduce import prices, which 
actually tends to improve the trade balance. Although the negative ef-
fects eventually dominate, some econometric estimates suggest that 
the full negative effect is not felt for more than 2 years.

As the effects of the strong dollar are increasingly reflected in U.S. 
trade, the trade deficit will widen. Economic developments elsewhere 
in the world will also contribute to a widening trade deficit. The re-
cession in other industrial countries will depress the demand for U.S. 
exports, and financial constraints in developing countries will lead 
them to import less. Both developments will have negative conse-
quences for U.S. exports. Record trade and current account deficits 
in 1983 will almost surely result.

Whether the trade and current account deficits persist will largely 
depend on U.S. macroeconomic policies, particularly on the fiscal 
side. If large budget deficits are allowed to continue to depress the 
U.S. national saving rate, real interest rates may rise again, sustaining 
or even increasing the high real exchange rate of the dollar. In this 
case the trade deficit could remain high for several years.

A large and sustained trade deficit would result in an economic re-
covery which would be "lopsided" in the sense that exporting and 
import-competing sectors would not share in the gains. Should this 
occur, government, business, and labor officials must bear in mind 
that even though protectionist foreign trade practices distort the 
composition of world trade and reduce economic efficiency both in 
the United States and abroad, large trade deficits are not the result 
of unfair foreign competition. Large projected U.S. trade deficits are 
a result of macroeconomic forces, particularly large budget deficits. 
The main sources of the U.S. trade deficit are to be found not in 
Paris or in Tokyo, but in Washington.

RESPONSES TO THE STRONG DOLLAR

The temporary adverse effects of a strong dollar create pressure to 
do something for the exporting and import-competing sectors. Three
kinds of policies might be used: microeconomic intervention in the form of protection or export subsidies, direct intervention in the foreign exchange market, and changes in monetary and fiscal policy.

Protection and Export Promotion

The negative effect of the strong dollar on the competitiveness of many U.S. firms has fueled pressures for an interventionist trade policy. These pressures must be resisted. Protecting import-competitive industries or subsidizing exports is not just a harmful long-run policy. With a floating exchange rate, such policies would fail to improve the trade balance or create employment even in the short run.

The exchange rate always moves to clear the market. An increase in exports or a reduction in imports would lead to an increased demand for or reduced supply of dollars on the world market, raising the exchange rate. This would lead to a further loss of competitiveness in the sectors not protected or promoted. An export subsidy for agricultural products would worsen the situation of the auto industry, an import quota on steel would hurt the competitiveness of the aircraft industry, and so on. Although these indirect effects may seem of doubtful importance in the real world, they are not. That governments cannot simultaneously protect everyone is a basic principle of international trade.

Instead of creating additional employment and output, the distortion of trade through protectionist policies or export promotion would probably reduce them. Market-distorting policies reduce the efficiency of the economy. Thus, a turn to protectionism could create a "supply-side" shock that might have the same kind of stagflationary effects as an oil price increase. The effects would prove still worse if, as is likely, U.S. actions were to provoke foreign retaliation.

Although protectionism and export subsidies provide no answer to the problems caused by a strong dollar, the pressure to use them is increasing. Many of the exporting sectors, which make up the traditional constituency for freer trade, appear to have become convinced by the strength of the dollar and the resulting loss of U.S. competitiveness that a more interventionist policy is needed.

Exchange-Market Intervention

Since March 1981 the United States has abstained as much as possible from direct intervention in the foreign exchange market. This unwillingness to intervene is based on doubts about whether exchange-market intervention is effective or desirable. As long as the Federal Reserve continues to pursue a policy of targeting monetary aggregates, any U.S. intervention on the foreign exchange market must be sterilized—that is, offset by other transactions on domestic fi-
nancial markets. These transactions are likely to wipe out most of the effect of the initial exchange-market intervention.

The process of sterilization is straightforward. If the U.S. Government attempted to drive up the price of foreign exchange and weaken the dollar by buying foreign securities, the Federal Reserve would issue dollars to pay for the foreign assets. In order to prevent these dollars from increasing the U.S. money stock, however, the Federal Reserve would then have to withdraw an equal number of dollars from the market by selling Treasury bills. The only net result would be that the world’s supply of dollar-denominated assets would increase, while its supply of assets denominated in other currencies would fall.

The increase in the level of dollar-denominated assets would probably have little effect on the exchange rate because of the sheer size of world financial markets. The world market in dollar-denominated securities includes not only the dollar assets actually owned abroad—foreign deposits in U.S. banks, foreign holdings of Treasury bills, Eurodollar deposits, and the like—but also all those dollar assets which are potentially tradeable. Thus, the total pool of internationally mobile dollar assets is probably in the trillions of dollars. This makes it questionable whether even very large interventions in the exchange market can have much effect on the exchange rate.

**Macroeconomic Policies**

Although the government cannot significantly affect exchange rates through direct intervention, monetary and fiscal policies do indirectly affect the exchange rate. A feasible strategy for bringing the dollar down would involve looser monetary policies and tighter fiscal policies. Both of these changes would tend to lower real interest rates (at least in the short run), making capital movement into the United States less attractive and thus driving down the value of the dollar.

Despite its unfortunate effects on the U.S. balance of trade, however, monetary restraint is the prime weapon in the fight against inflation. Disinflation, as we have learned, unfortunately involves substantial costs. Under fixed exchange rates the heaviest costs of monetary contraction and disinflation fell on the interest-sensitive sectors of the economy, such as construction and consumer durables. With floating exchange rates, however, much of the burden also falls on exporting and import-competing sectors, which are injured by the rise in the value of the dollar.

A tighter fiscal policy would also lower real interest rates and lead to a lower dollar. Under fixed exchange rates, budget deficits crowded out domestic investment. With a floating exchange rate they crowd out exporting and import-competing products as well. A re-
duction in deficits would lead—with some lag—to an improvement in the trade balance as well as higher investment.

The strength of the dollar has put considerable strain on the resolve of the United States to remain committed to free trade. This strain is not unique to the international sector. The recession and high interest rates have also put a strain on the resolve to let other types of markets, from housing to labor markets, operate freely. If there is special reason for concern about the international side, it is because of the danger that mistakes in U.S. policy could set off a spiral of retaliation among all the major trading nations.

The competitiveness of U.S. business as a whole—as opposed to that of particular sectors—and the balance of payments are macroeconomic phenomena. Microeconomic interventions cannot cure macroeconomic problems; they can only make one sector better off by hurting other sectors even more. The most effective strategy the United States can pursue for its exporting and import-competitive sectors is to get its overall economic house in order—above all, by bringing budget deficits and real interest rates under control.

MACROECONOMIC PROBLEMS IN EUROPE

More than 90 percent of the output of the industrial countries, and more than 70 percent of the output of the world's market economies, is produced by the United States, Japan, and the European Economic Community. Table 3–6 shows some comparative figures for the three. The most striking feature of the table is the favorable performance of Japan by all measures. The United States and the European Economic Community look rather similar in their less favorable performances. They experienced nearly the same growth rates before 1979, have suffered nearly equal decelerations of growth since then, and had roughly the same unemployment rate in 1981. The U.S. inflation rate was lower than that in Europe, but the United States also showed lower productivity growth.

Behind the similarity of U.S. and European experience, however, lies a major difference. The U.S. economy, whatever its other difficulties, has provided employment opportunities for a rapidly growing labor force. The current high unemployment rate is a cyclical problem, not the result of a persistent failure of employment to expand. In Europe, by contrast, employment was virtually stationary over the last decade, and unemployment has risen in every year since 1973. This is a worrisome aspect of the European situation.

For a given rate of unemployment, the strains on society are probably greater if employment is stagnant than if it is growing. Growing employment means that more new jobs are always opening up, offer-
ing job losers a chance for reemployment and new entrants to the labor market a chance to get their first job. If employment is stationary, workers who have lost their jobs may stay unemployed for a long time, and young people may never find jobs. The results of near-zero employment growth are painfully visible in Europe, where long-term unemployment (more than 6 months) is several times higher than in the United States, and where the share of youth unemployment in the total pool of unemployed has risen steadily since 1973.

How did the problem arise? The causes of structural unemployment are always controversial, but a key element in the European employment problem was probably rapid increases in real labor costs in the first half of the 1970s in the face of declining productivity growth and rising oil prices. These increases in labor costs—which stemmed at least in part from increases in social insurance payments—squeezed profitability. Firms closed their marginal plants and invested in increasingly capital-intensive techniques, which helped to sustain the rate of productivity growth but also led to employment stagnation.

The unemployment problem in Europe is not caused solely by excessive labor costs. The periods of rapid increase in European unemployment, in 1973–76 and since 1979, came during business cycle contractions (Table 3-7). The most recent rise in unemployment is probably mostly due to restrictive monetary and fiscal policies adopted by the European countries following the oil price shock of 1979. These policies were adopted out of concern that the rise in import prices resulting from that shock—and, later, the further rise in import prices resulting from the appreciation of the dollar—would lead to an uncontrollable inflationary spiral. Thus, recent developments in the European economy are to some extent similar in character to those in the United States, which have also resulted largely

\[\text{Table 3-6. Economic performance by major industrial countries, 1973-82 (Percent)}\]

<table>
<thead>
<tr>
<th>Item</th>
<th>United States</th>
<th>Four large European countries</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth rate in:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real gross domestic product (GDP), 1973-80</td>
<td>2.3</td>
<td>2.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Real GDP per employed person, 1973–80</td>
<td>2</td>
<td>2.2</td>
<td>3.0</td>
</tr>
<tr>
<td>Level:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer price inflation, year ending 1982:II</td>
<td>6.8</td>
<td>10.2</td>
<td>2.4</td>
</tr>
<tr>
<td>Unemployment rate, 1981</td>
<td>7.6</td>
<td>7.4</td>
<td>2.3</td>
</tr>
</tbody>
</table>

1 France, Germany, Italy, and United Kingdom.
Sources: International Monetary Fund and Organization for Economic Cooperation and Development.

http://fraser.stlouisfed.org/Federal Reserve Bank of St. Louis
from disinflationary policies. The European situation is more serious, however, because the current recession comes on top of a steadily growing structural unemployment problem.

**Table 3-7.—Employment and unemployment in the European Economic Community, 1973–80**

(Percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase in employment</th>
<th>Unemployment rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>1.1</td>
<td>2.8</td>
</tr>
<tr>
<td>1974</td>
<td>-1.1</td>
<td>3.0</td>
</tr>
<tr>
<td>1975</td>
<td>-1.1</td>
<td>4.2</td>
</tr>
<tr>
<td>1976</td>
<td>-1.1</td>
<td>4.9</td>
</tr>
<tr>
<td>1977</td>
<td>.4</td>
<td>5.2</td>
</tr>
<tr>
<td>1978</td>
<td>.6</td>
<td>5.3</td>
</tr>
<tr>
<td>1979</td>
<td>.8</td>
<td>5.3</td>
</tr>
<tr>
<td>1980</td>
<td>.2</td>
<td>5.7</td>
</tr>
</tbody>
</table>

Source: Organization for Economic Cooperation and Development.

The United States has a major stake in the success of the European countries in dealing with their macroeconomic problems. The stake is not simply due to the fact that the major European countries are also allies of the United States, nor is it simply due to the fact that roughly one-quarter of U.S. exports go to Western Europe. More than this, Europe is a key part of the world economy, with an aggregate GNP as large as that of the United States itself. If European countries remain mired in economic stagnation and turn toward increased protectionism as a consequence, little chance will remain of saving the open trading system.

**THE INTERNATIONAL DEBT PROBLEM**

Different problems from those facing the United States and Europe afflict the economies of the developing nations. The problems of these economies have accumulated over the last several years and are products of both domestic policy mistakes and external developments, such as oil price increases, the recession in industrial countries, and high real interest rates. In the summer and fall of 1982 the problems came to a head in the form of a sharp reduction in international lending to the developing countries.

**DEBT-FINANCED GROWTH IN THE 1970s**

Until recently, the growth of such middle income developing countries as Brazil, South Korea, and Taiwan was widely viewed as one of the great success stories of the 1970s. Particularly notable was their success in expanding exports of manufactured goods. While the growth of these exports did give rise to some adjustment problems in industrial countries, the successes of some middle income countries...
were undoubtedly a highly favorable development for the United States. Such success provided a dramatic demonstration to other countries of the potential of market-oriented economic policies.

An important aspect of growth in the developing world, however, was heavy borrowing from foreign sources. There is nothing inherently wrong in external borrowing to finance growth. Some of the developed countries, including the United States, relied heavily on foreign capital during earlier periods of industrialization. But some developing nations borrowed too much, investing in projects of doubtful productivity. When overly optimistic expectations about export earnings and interest rates turned out to have been wrong, these countries found themselves in serious financial difficulty.

From 1973 to 1981 the medium- and long-term external debt of non-oil developing countries rose at an annual rate of more than 20 percent. Lenders might have viewed this rate of increase as more alarming than they did, were it not for several factors which appeared to indicate that the eventual repayment of the debt would not impose a severe burden on borrowing countries. These factors included:

- **A rapid growth in the ability of these countries to service their debt.** Exports of the non-oil developing countries grew at an annual rate of 18 percent.
- **Very low real interest rates.** From 1973 to 1979 Eurodollar rates in London, which set the basis for most international lending, averaged 8.5 percent, while U.S. wholesale prices rose at an annual rate of 9.8 percent. Even allowing for the fact that third-world borrowers paid small spreads over the Euromarket rate, the real interest rates they paid were still negative.
- **Special factors which appeared to ensure rising export earnings in the future.** The most important of these was oil reserves, which were essentially treated as an asset against which countries could safely borrow.

### CAUSES OF THE LIQUIDITY PROBLEM

Excessive borrowing by some developing countries made an eventual financial problem inevitable. The proximate factor which brought the era of debt-financed growth to a halt was, however, a sharp deterioration in the world economy. The rise in oil prices in 1979 was a blow to many debtor countries, and further strains resulted from disinflation in the United States and other industrial countries. The factors which led to a loss of lender confidence in the developing countries included:

- **The effects of the world recession on export demand.** The rapid export growth of the 1970s came to an abrupt end in the early 1980s. Exports of the non-oil developing countries actually fell by 7.5
percent from the first half of 1981 to the first half of 1982. Exporters of primary products were hit particularly hard: real commodity prices fell by 25 percent from the fourth quarter of 1980 to the second quarter of 1982.

- **High real interest rates.** In 1981 and the first half of 1982, Euro-market interest rates averaged 16 percent, while wholesale prices in the United States rose at an annual rate of only 4.5 percent.
- **The appreciation of the dollar.** Since most international debt is denominated in dollars, while commodity prices tend to follow a weighted average of industrial country currencies, the effect of the rise in the value of the dollar was a sudden increase in the size of developing country debt relative to prospective export earnings.

The result of these developments was that banks, which had been willing to lend large amounts to developing countries throughout the 1970s, lost confidence that the loans would be promptly repaid. The debtor countries were highly vulnerable to such a loss of confidence. Much of their debt was of short maturity, so that a large fraction of their debt required refinancing each year. Argentina, Brazil, and Mexico, for example, must make annual payments of principal and interest which exceed their total exports of goods and services. During the 1970s these large financing needs did not pose a problem, since countries were able to roll over their debt as it came due. In the summer and fall of 1982, however, banks became reluctant to make new loans and roll over old ones, first to Mexico and then to other countries. The result was a quick exhaustion of the foreign exchange reserves of the major debtors.

**IMPLICATIONS OF THE DEBT PROBLEM**

The debt situation of the developing countries poses two problems for the world economy. Although quite unlikely, failure to resolve the debt situation in an orderly way could lead to major financial market disruptions. More likely—indeed, it has already happened to a considerable extent—is a situation of forced austerity in debtor countries, with adverse effects on world trade and output.

**Risks to Financial Markets**

The threat of a financial disruption arises from the possibility that debtor countries will be unable to live within their new financial constraints. The unwillingness of banks to lend as much as in the recent past means that debtor countries will need to cut their imports or expand their exports. In the case of the most heavily indebted countries, this will almost certainly mean achieving substantial trade surpluses in spite of depressed demand for their exports. The concern
of lenders that some debtors will not be able to achieve the required adjustment is precisely what makes them reluctant to lend.

Fortunately, a serious financial disruption is unlikely. The debtor countries and the banks which are their major creditors share a strong interest in an orderly resolution of the debt problem. For the debtor countries, maintaining good financial standing is essential if they are to maintain access both to world capital markets and to their export markets. At the same time, banks realize that demanding too rapid a repayment from debtor countries could prove counterproductive, and they are probably willing to provide enough financing so that debtor countries can more easily handle the financial squeeze. Although banks find themselves in somewhat of a “prisoner’s dilemma” situation, in which no one bank will want to lend if it believes that the loans will only go to repay other banks, this problem should not prove insoluble. The banking community should be able to work with the International Monetary Fund (IMF) in negotiating agreements which balance an adequate degree of new lending to the debtor countries with realistic economic adjustment plans. To aid in this process, the Administration and representatives of other industrial nations recently agreed in principle to an enlargement of the IMF’s resources.

Perhaps the most important safeguard against a financial crisis is the ability of the governments and central banks of the major industrial countries to provide a safety net for the international financial system. Central banks act as lenders of last resort for commercial banks, providing effective protection against banking panics. At the same time, industrial country governments have demonstrated their willingness to help provide temporary financing for developing countries in order to bridge the interval until agreements can be reached with the IMF. (The IMF recently concluded agreements with Mexico, Argentina, and Brazil.)

Effects on World Trade

Although a serious disruption of the international financial system is unlikely, for all of the reasons cited, serious problems still exist. Even under optimistic assumptions, those developing countries with high ratios of debt to exports will be forced to improve their trade balances substantially in order to pay the interest on their debt. Much of this trade balance improvement will probably come through reductions in imports, involving painful reductions in output and real wages in the debtor countries. This will also depress demand for the products of industrial countries—particularly the United States, which has especially close trading relations with some of the major Latin American debtors. The debt problem of the developing countries may worsen the U.S. trade balance by $10 to $20 billion and
reduce U.S. GNP by one-half percentage point or more from the level it would otherwise reach.

The Outlook for Debtor Nations

The problems of the developing countries are not insoluble. If growth in the world economy resumes and real interest rates fall to historical levels, the debt burden of even the most heavily indebted countries will become much more manageable. Mexico and Brazil, among the most heavily indebted countries, both have debts well below half their GNPs. At a historically typical real interest rate of 2 percent, the real burden of debt service would fall to less than 1 percent of GNP—a fully manageable level in a growing economy.

The key to recovery from the debt problem, however, lies in increased exports from the debtor countries. Import restrictions by the developing countries can only accomplish so much in improving their trade balances. Imports have already fallen considerably in high debt countries in the last year, leaving limited room for further cuts. As growth resumes among the debtor countries, they will tend to import more, and will need to export more to pay for the imports. They will not be able to do this if the industrial countries, including the United States, institute new protectionist measures. Yet as developing countries attempt to increase their exports, strong political pressures will develop in the industrial countries to stop them. Leaders in the industrial countries must realize that shutting out imports from the developing world will not only incur the usual costs of protection—higher prices to consumers and jobs lost in unprotected sectors—but also will threaten the basic stability of the world financial system.