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FEDERAL RESERVE BANK OF ST. LOUIS

Review

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FEDERAL RESERVE BANK
OF ST. LOUIS

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Growth in Money Slows

SINCE THE INCREASE in the Federal Reserve discount rate and the raising of interest rate ceilings permitted on time and savings deposits at commercial banks in late November, interest rates on short-term securities have risen, and there has been a slower rate of monetary expansion. At the same time, however, bank credit has risen at an accelerated rate.

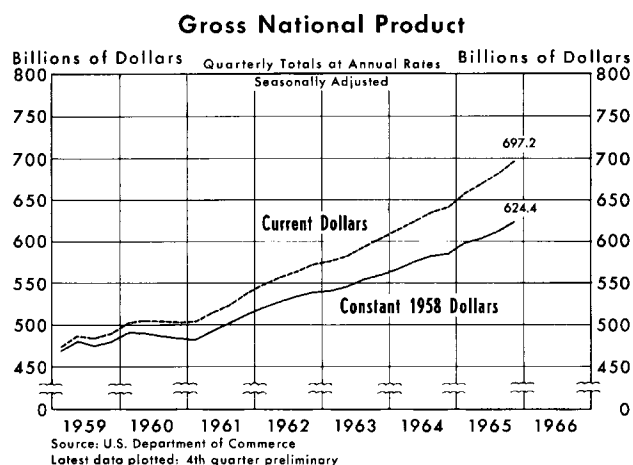
Interest Rates Rise

Following the increase in the Federal Reserve discount rate from $3\frac{1}{2}$ per cent to 4 per cent, effective November 24 at the St. Louis bank, interest rates on money market instruments worked higher. Yields on 90-day Treasury bills rose from 3.61 per cent in the week ending November 20 to 3.83 per cent in the last week of 1964. Since then, yields have risen further, to about 4.00 per cent in early March. For several months prior to late November bill yields had moved within a narrow range around 3.50 per cent, the previous discount rate. The rise in bill yields during early 1965 is in contrast to a usual decline in yields at this season.

Other short-term interest rates have also risen since late November. Yields on six-month Treasury bills rose from 3.77 per cent to 4.02 per cent in early March, rates on finance company paper rose from 3.88 per cent to 4.25 per cent, and rates on prime bankers' acceptances advanced from 3.75 per cent to 4.25 per cent.

Interest rates on longer term securities have been about unchanged in recent months. Following the rise in the discount rate, yields on long-term Government bonds rose from 4.11 per cent to 4.15 per cent in early December. Subsequently, they have been

cent annual rate from the third to the fourth quarter of last year compared with a 6 per cent rate from 1960 to 1965 and a 5 per cent rate since 1953. Retail sales,



an indication of spending which is available more currently, jumped at a 13 per cent annual rate from October to January. This compares with a 5 per cent rate from 1960 to 1965 and a 4.4 per cent rate since 1953. Preliminary data indicate that sales continued to rise in February.

Expanding production of goods and services has matched much of the surge in spending. Total real output rose at an estimated 8 per cent annual rate from the third to the fourth quarter of 1965 compared with a 4.5 per cent rate from 1960 to 1965 and a 3.3 per cent rate since 1953.

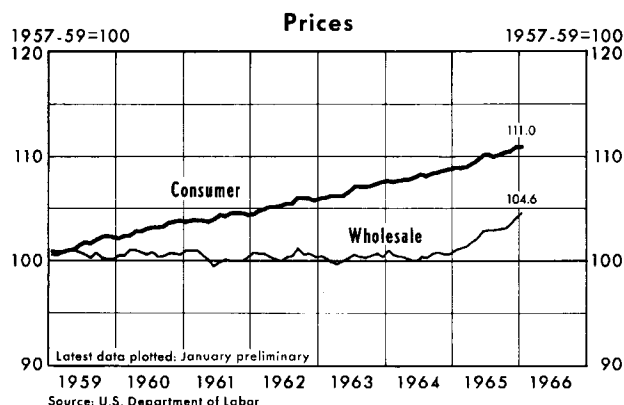
Industrial production jumped at a 14 per cent annual rate from October to January compared with a 6 per cent growth rate from 1960 to 1965 and a 3.8 per cent rate of gain since 1953. A part of the recent spurt in output was a recovery in steel production following the temporary slowing last fall after the labor contract settlement. However, even adjusting for this special situation, industrial output rose markedly in the late fall and early winter.

During this vigorous rise in output, the economy absorbed all of the increase in the labor force and a large number of unemployed. Total employment rose at a 6.5 per cent annual rate from October to January compared with a 1.6 per cent rate from 1960 to 1965 and a 1.3 per cent average rate since 1953.

In January 4.0 per cent of the civilian labor force was not working compared with 4.3 per cent last October, 4.8 per cent a year ago, and a 5.7 per cent average in 1963. Only 1.9 per cent of the married men in the labor force were out of work in January, an unusually low figure since it includes those changing jobs, those seasonally unemployed, and some who are

unemployable. Since October the average hours worked in manufacturing have been 41.4 per week compared with 41.0 per week during the previous three months.

The rise in spending has been faster than the increase in real output, meaning that prices have risen.



From October to January wholesale prices were marked up at a 6 per cent annual rate compared with 2.3 per cent during the previous year and virtual stability from 1958 to 1964. Weekly data indicate that wholesale prices continued to rise in February. The sharpest rises have been in farm products and processed foods, but markups have also occurred in many other items.

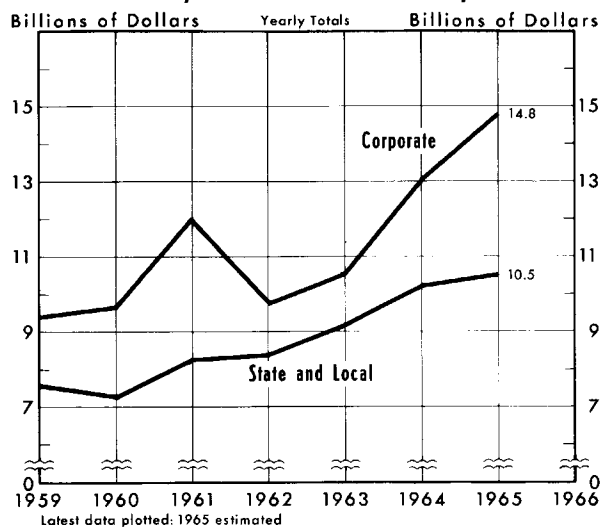
Consumer prices rose at about a 2 per cent annual rate from October to January. By comparison, these prices trended upward at a 1.4 per cent rate from 1953 to 1965.

Financial Developments

Financial developments in recent months have reflected the strong business situation and, at the same time, have been a factor in facilitating and stimulating the expansion in spending.

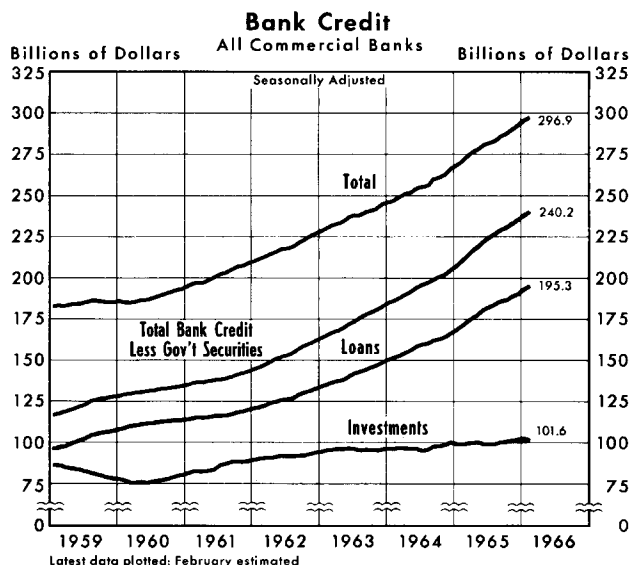
Sharply higher private investment and a Government deficit, combined with steadily rising consumer and state and local government debt, have intensified credit demands. With the demand outlook becoming more optimistic, percentage utilization of productive capacity rising, and prices moving up, business has been seeking funds to build plant, to purchase equipment, and to expand inventories. The intensity of corporate credit demands is witnessed by a sharp rise in business loans and record levels of security offerings for new capital. The Government has also been a large net borrower, with the total gross Federal debt rising from \$317.1 billion in July to \$322.4 billion in January.

Security Issues for New Capital



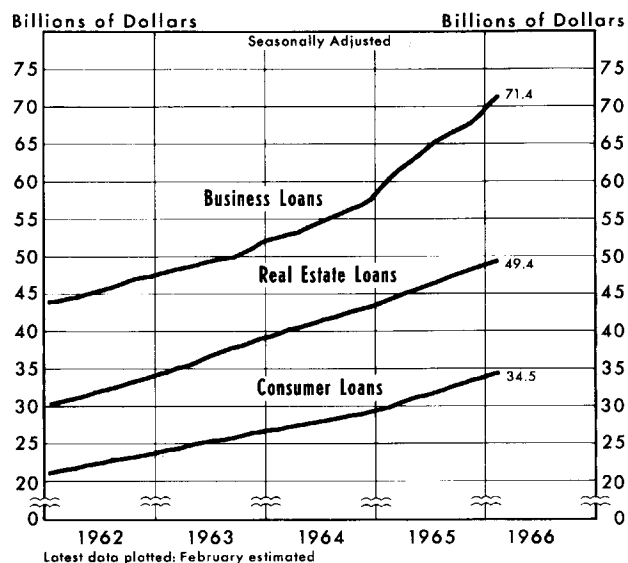
Supplies of funds have been large. Most of the funds have come from personal saving and retained business earnings, but these supplies of funds have been supplemented by an increase in the money supply. Part of the flow of saving into investment has been channeled through the commercial banks and has been reflected as part of the bank credit expansion.

Bank credit (loans and investments) has risen rapidly in recent months. Total bank credit expanded at an



estimated 10 per cent annual rate from October to February compared with an 8 per cent rate from 1960 to 1965 and a 6 per cent growth trend since 1953. Recently, increases in bank loans, especially to business, have been particularly sharp. Business loans at all commercial banks increased at an estimated 23 per cent annual rate from November to February

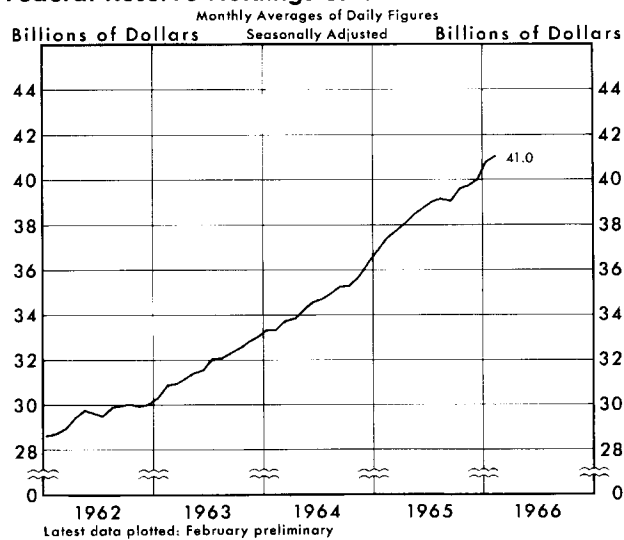
Loans at All Commercial Banks



compared with a 20 per cent rise in the preceding year.

The growth in bank credit has been made possible by a sizable rise in reserves of banks, which are influenced by Federal Reserve System actions. Federal Reserve purchases of Government securities, the primary means used to increase reserves, have been large

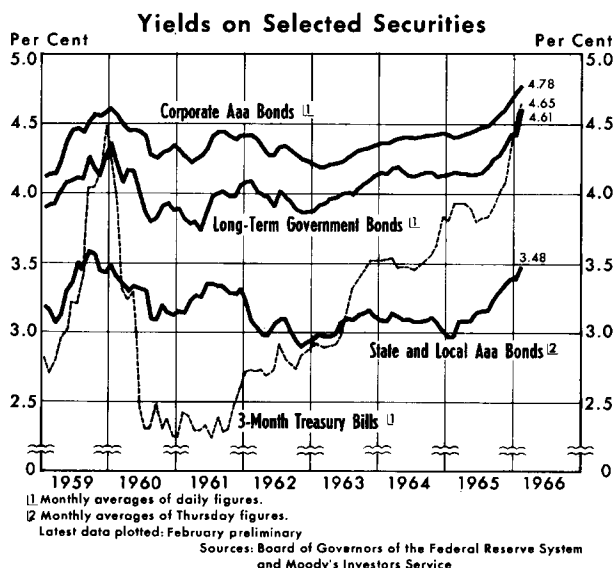
Federal Reserve Holdings of Government Securities



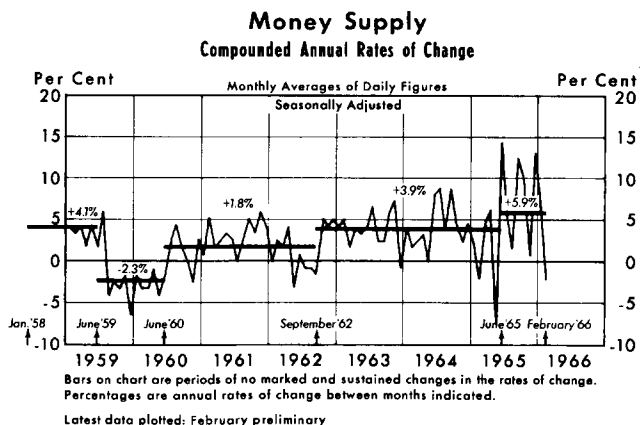
in recent months. Total member bank reserves increased at an 8 per cent annual rate from October to January compared with a growth rate of 2.9 per cent per year since 1958. From early January to late February total reserves declined slightly.

Since summer the surge in credit demands has exceeded supplies. Interest rates have risen markedly, and lender requirements have grown more restrictive to ration available funds.

Yields on three-month Treasury bills rose from 3.83 per cent in July to 4.63 per cent in early March. Interest rates on long-term Government bonds rose from 4.15 per cent to 4.70 per cent over the same period. Similar increases have developed in rates on high-grade corporate and municipal obligations, and interest rates on mortgages rose substantially in December and January.



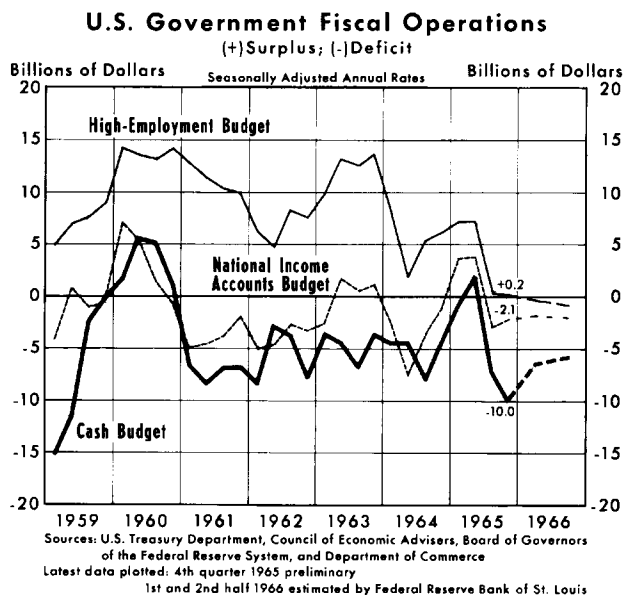
The bank credit expansion in late 1965 was accompanied by a sharp growth in demand deposits. These deposits plus the currency outside banks make up the money supply of the country. Hence, the money supply rose very rapidly in the last half of 1965. From last June to late December the money supply rose at an 8 per cent annual rate compared with a 4 per cent rate from September 1962 to June 1965 and a 1.5 per cent



average rate from 1953 to 1962. Sharp increases in the volume of money have usually been followed by increased spending. In February the money stock was slightly below the high level reached in late December.

The Budget and Projections of Output and Prices

Government expenditures and receipts, according to the Federal budget, are expected to rise sharply in the first half of 1966. The deficits in the consolidated cash and national income accounts budgets are expected to lessen slightly from the last half of 1965 to the first half of 1966.



The high-employment budget, however, is expected to move from a small surplus in the latter half of 1965 to a slight deficit in the first half of 1966. This budget adjusts the national income accounts budget for changes in the level of economic activity. The smaller the surplus or greater the deficit in this budget, the more stimulative the impact of fiscal operations and the less the dependence on private demand to maintain high employment. By this measure, the impact of Federal actions will be more stimulative in the first half of 1966 than at any other time in recent years.

A shortcoming of each of the above-mentioned budgets is that Government expenditures are not recorded on an accrual basis. The impact on employment and production of increased Government procurement of military hardware occurs when contracts are let and orders placed. However, these purchases do not show up in Federal budgets until later, when actual expenditures are made. Since the Government currently is placing large procurement orders, the impact of the Government on the economy may be even more stimulative in early 1966 than indicated by any of the conventional budget concepts discussed above.

Based on data available in December, the Council of Economic Advisers projected a GNP of \$722 billion

and a price rise of 1.8 per cent for 1966. Data now available for the fourth quarter of 1965 and for January and February indicate that these figures may be on the low side. The GNP figure for the fourth quarter of 1965 was revised upward on February 14, indicating that the base used by the Council for predicting was probably low. In addition, in recent months major price indexes have risen rapidly. The recent revisions of data for late 1965 and price increases in early 1966 may call for upward revisions of the Council's 1966 estimates.

There is not much disagreement about seeking a target GNP which would provide for reasonable growth. What fiscal and monetary stance may best achieve such an objective is a matter for continuing consideration and discussion. The nation must continue to struggle with the problem of choosing a combination of fiscal and monetary policy which will result in an appropriate total demand for goods and services.

Summary

The flow of spending, which has been expanding at a faster-than-trend rate since early 1961, has increased markedly since last fall. The greater outlays have brought forth more production, reduced the volume of idle resources, and also caused price increases.

Financing the greater activity has placed great strains on credit markets. Supplies of funds have been large. Yet demands have seemed to be insatiable, and there has been tightening in credit conditions, including a marked rise in interest rates. The money supply has been expanded as bank credit rose, and the greater money stock, in turn, may be an expansive factor in the current economic situation. The economic impact of Government spending and taxing actions, as well as the granting of contracts for future delivery, may also be expansionary in the first half of 1966.



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The Emergence of Hard Currencies in the Postwar Period

Introduction

INTERNATIONAL FINANCIAL arrangements and the balance of payments have become of increasing importance and interest to the American public. One aspect of the background of the current international financial situation is considered here.

A major international controversy which surfaced for the first time into public view at the Tokyo meetings of the International Monetary Fund (IMF) in September 1964 was the question of the future provision of international liquidity.¹ In particular, the use of the dollar as the major reserve currency was seen by some as a serious weakness in the present international payments system. The strongest statement in favor of moving away from the dollar in international finance came from the French Minister of Finance, Valéry Giscard d'Estaing. The U. S. Secretary of the Treasury Douglas Dillon defended the role of the dollar but admitted that some modifications in international monetary arrangements were needed to provide future additions to international liquidity.

Dissatisfaction with the present world payments system had grown out of deficits in the U. S. balance of payments and the decline in U. S. international reserves; but this means that there must have been surpluses and increases in international reserves for the rest of the world. The deficits in the United States are reflected in surpluses in the other industrial countries. It is the surpluses which these countries have enjoyed since the late 1950's which have given them "hard" currency status.²

¹For several years prior to the Tokyo meetings there had been some controversy surrounding the liquidity question. However, this was the first time that the IMF officially published a discussion of the problem to be faced in providing for future liquidity.

²There are some less developed countries which have hard currencies. However, their hard currency status is due to factors which are different from those which determine hard currencies in industrial countries. Both Kuwait and Saudi Arabia have hard currencies because of the colossal good fortune of having a major share of the world's oil reserves within their

This article investigates the question of what factors contributed to the timing of other countries' achievement of hard currency status. Hard currency will be defined, and a generalization concerning the timing of its emergence or disappearance will be considered and compared with the experience of the European Economic Community (Common Market or EEC) countries and Japan.

Hard Currency—A Definition

There is no universally recognized definition of "hard currency." The term as generally used is roughly equivalent to currency convertibility. Unfortunately, convertibility is an ambiguous term. Quite a few countries permit convertibility for nonresidents who have acquired their currencies in ways which are approved by the exchange authorities; however, there may be restrictions on the amount which can be converted in any one year or from any given source. A smaller number of countries also permit currency conversion for residents; this convertibility is generally restricted to payments for the current account, that is, for goods and services purchased abroad. Capital movements, on the other hand, are now almost universally restricted to some extent.

Formal recognition that European currencies were convertible came late in 1958 when the EEC countries accepted the provisions of Article 8 of the International Monetary Fund Articles of Agreement which assured nonresident convertibility for current account transactions. In addition, toward the end of 1960 these

national boundaries, and oil revenues are so large a share of national income. Other countries with large windfall oil receipts do not have hard currencies because their receipts represent a relatively small share of national income. Still other countries have so badly managed the development of their natural resources that no important or lasting benefits have resulted. Jordan is an interesting example of a country with no industry or natural resources which has a hard currency. This is due to three factors: the heavy inflow of foreign exchange as a direct budget support provided by the United States and the United Kingdom, the relatively modest development program of the government, and the institutional arrangements which tie the Jordanian dinar 100 per cent with the pound sterling. Most nonindustrial countries have weak currencies because of inflationary financing of domestic development with resulting overvaluation of the currency. National pride does not permit the currency to be devalued to a more realistic rate.

same countries accepted the Code of Capital Liberalization of the Organization for Economic Cooperation and Development (OECD). Japan accepted Article 8 of the IMF and the OECD Code of Capital Liberalization in 1964.

Not all convertible currencies, however, can be considered equally hard in that, over time, some convertible currency countries will be observed to run large average surpluses while other convertible currency countries run deficits. Convertibility only insures that foreign exchange controls are sufficiently relaxed (both qualitatively and quantitatively) that the normal supply and demand for a given currency is largely satisfied in the official foreign exchange market. Balance-of-payments surpluses are required over a period of years to insure an excess demand for a currency in the world market. An occasional balance-of-payments deficit is of course consistent with the maintenance of hard currency status. For the purposes of this article a nonreserve currency country will be considered to have a hard currency if its currency is convertible and its balance of payments is on the average in surplus.

Emergence of Hard Currencies— A Generalization

This article inquires into the possibility that the emergence of hard currencies was associated with the end of the postwar period of recovery and technological catching-up and that the hard currency status can be delayed, or once achieved, can be lost because of extraordinarily expansionary domestic policies. For the purposes of testing this generalization, the postwar experience of six industrialized countries has been divided into three phases: (1) early postwar recovery; (2) sustained growth and emergence of hard currency; and (3) recent inflationary developments.

Phase I covers the early postwar period of recovery and technological catching-up. The overriding economic problem of this period was the promotion of rapid economic growth in order to bring the standard of living back to and then above its prewar level. During this period any country faced with a choice between maintaining a high rate of growth in domestic income and having a hard currency would be expected to choose the former. In a trade-off between domestic real income growth in the fairly near future and short-run external economic strength, a very high premium was quite reasonably given to the growth option; this was not only a rational economic choice but also good politics. Marshall Plan aid to the European countries and GAREOA³ aid to Germany and Japan

made this choice feasible because it provided the necessary financing for the early balance-of-payments deficits.

At some point in time, varying from country to country, the recovery and catching-up was largely accomplished, and the average growth rate of real domestic product declined toward a more sustainable long-term level. When this point was reached, a country entered Phase II. During this phase a country became a candidate for hard currency status. A slowdown in the real growth rate and hard currency status are associated for a variety of reasons: (1) a decline in the rate of import growth is associated with the slowdown in the general growth rate; (2) maintenance of a high rate of export growth is possible because a favorable environment for domestic investment has created a technologically efficient capital plant capable of competing in international markets; and (3) net private foreign capital inflow is attracted both by the high rates of return that sustained economic growth permits and by the prospect for exchange rate stability and convertibility. All of these factors contribute directly to improving a country's balance of payments and therefore to the emergence of hard currency status.

A country is not insured hard currency status simply by moving into Phase II. If the authorities follow an excessively expansionary policy, the balance of payments will continue to be weak, as in the case of Japan. On the other hand, a currency may become hard even with expansionary policies and price inflation if it can be devalued, as in the case of the French franc in the late 1950's.

Phase III occurs when a country has experienced balance-of-payments surpluses for some years and becomes susceptible to inflationary pressures, which tend to weaken the balance of payments. This tendency is reminiscent of the international gold standard mechanism which operated in the late nineteenth and early twentieth centuries. In that period, when domestic money supply was linked to a country's gold holdings, a balance-of-payments surplus increased the money supply, and rising domestic prices and incomes tended to weaken the balance of payments. Conversely, a balance-of-payments deficit reduced the money supply, domestic prices, and income and tended to strengthen the balance of payments. Although money supply is no longer automatically linked to gold holdings, the balance of payments still seems to affect domestic price levels. This may be because authorities who now control the stock of money feel freer to pursue domestic objectives vigorously when the balance of payments is in surplus than when it is in deficit.

³United States Government Assistance and Relief in Enemy Occupied Areas.

Emergence of Hard Currencies— Experience of Some Industrial Countries

Data for each of the five major countries of the Common Market and Japan are considered to determine the extent to which their experience has conformed to the pattern outlined above. All of these countries were badly disorganized by the war, and all have had successful recovery and sustained growth over the past 15 to 20 years. For all the countries, except Germany and Japan, the period considered is 1948 to 1965.⁴ An attempt has been made to divide the total period under consideration for each country into the three phases described above, on the basis of data presented in the table below.

SELECTED ECONOMIC INDICATORS

Six Countries						
1948-65						
Phase	MS	IP	WP	Im	Ex	BP
A. France						
I (1948-57)	16%	7%	6%	7%	11%	\$— 596
II (1957-62)	12	5	5	4	8	488
III (1962-65)	12	5	2	11	10	152
B. Germany						
I (1951-55)	12%	10%	0%	14%	15%	\$ 671
II (1955-63)	10	6	1	11	12	1,578
III (1963-65)	9	6	2	17	10	404
C. Italy						
I (1948-55)	13%	10%	—1%	8%	8%	\$— 289
II (1955-59)	9	7	—1	6	12	108
III (1959-65)	14	8	2	15	16	138
D. Belgium						
I (1948-56)	4%	4%	1%	6%	8%	\$ 100
II (1956-62)	4	3	0	6	5	148
III (1962-65)	8	6	2	11	13	— 18
E. Netherlands						
I (1948-56)	4%	8%	4%	9%	14%	\$ 36
II (1956-62)	5	5	0	6	8	97
III (1962-65)	10	7	4	12	11	— 4
F. Japan						
I (1952-61)	14%	15%	0%	12%	14%	\$— 48
II (1961-65)	23	9	1	9	19	— 86

NOTES: The statistics for money supply (MS), industrial production (IP), wholesale prices (WP), imports (Im), and exports (Ex) are averages of compounded annual rates of change.

The balance of payments (BP) data are averages, in millions of dollars, of the balance on current account, i.e., goods and services.

Sources: IMF, *International Financial Statistics, Supplement on Money*, 1964, *International Financial Statistics, Supplement to 1965/66 Issues*, and *Balance of Payments Yearbook*, Vols. 9-15. Data for 1965 were estimated by the Federal Reserve Bank of St. Louis on the basis of figures presented in *International Financial Statistics*, December 1965.

⁴The immediate postwar years were omitted partly because of the unavailability of consistent data and partly because real recovery did not start until after the currency reforms and devaluations of 1948-49.

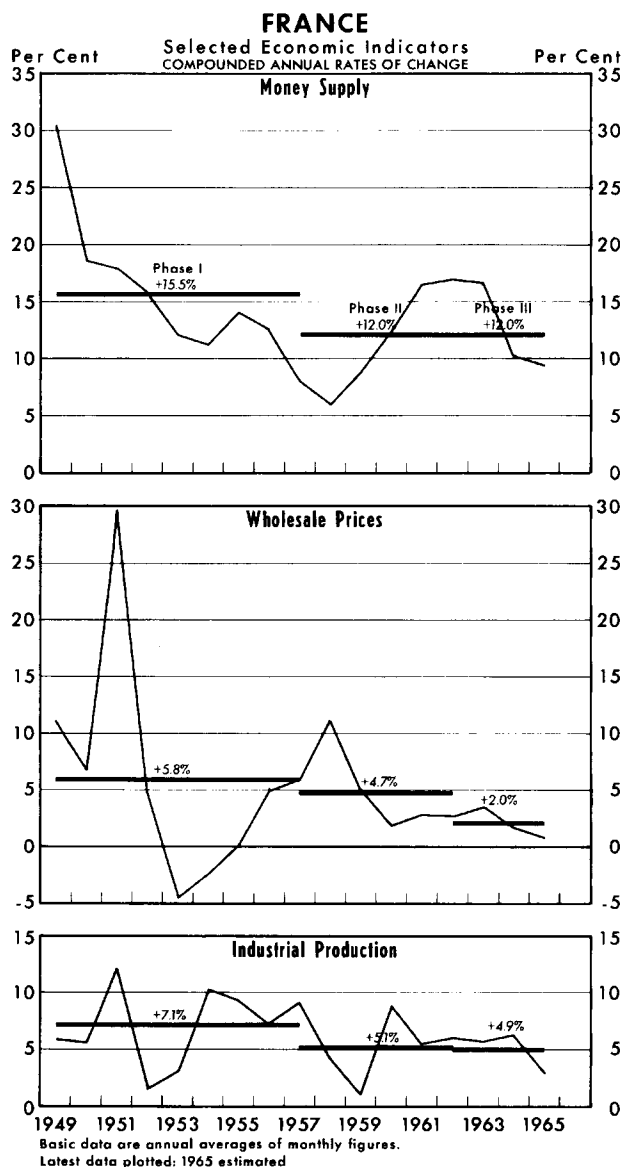
In this table money supply has been presented as an indicator of the nature of monetary policy. It is recognized that data on interest rates and other measures, if available, would also be useful in this context. Industrial production has been used as an indicator of real output. It is considered more relevant than real GNP for the purpose of this article because it excludes services and is thus a better measure of the share of real income which influences foreign trade. The wholesale price index has been used because it provides the best measure of the level of prices of goods which move in international trade. Considering industrial production and wholesale prices in combination provides an indication of changes in output measured at current prices. The balance-of-payments data show balance on current account.⁵

Phase I: Recovery and Technological Catching-Up.

In the EEC countries (except Germany) this phase apparently started in 1948 and lasted through the middle of the 1950's, with the exact terminal dates varying between 1955 and 1957. In Germany Phase I began in 1951 and extended through 1955. For Japan this phase began later (1952) and also ended later (1961).

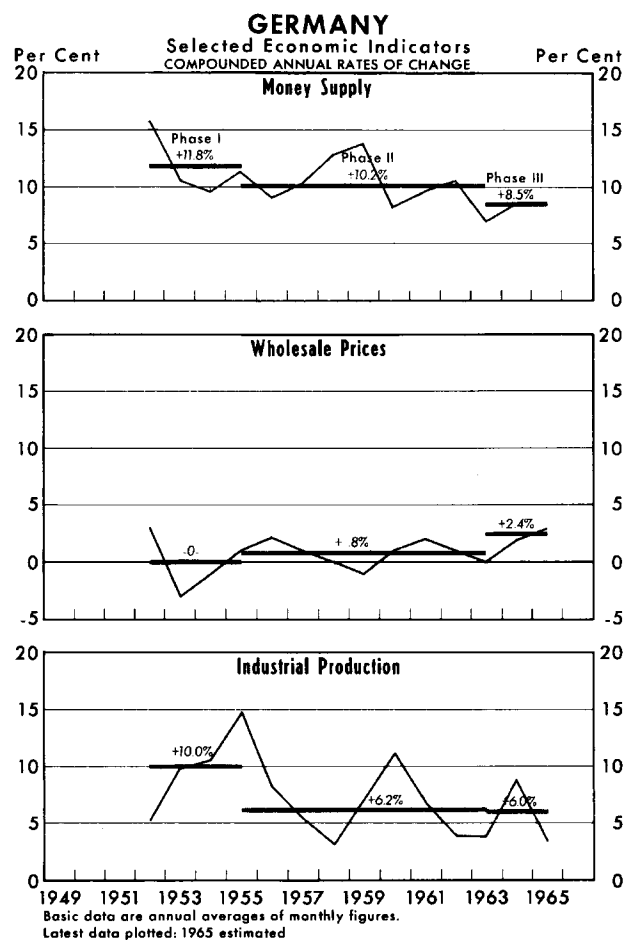
The rate of growth of industrial production during this phase was higher than in any other phase in five of the six countries considered. Only Belgium did not exhibit a historically high growth in production in Phase I. This may be because it suffered less physical destruction during the war than some of the other countries considered. This was a period of little or no price increases in four of the six countries. France, which had substantial price increases, was able to wipe out their effect on its international competitive position by devaluations in 1957 and 1958. Although the import growth rate was substantial in all countries, it was roughly proportional to the rate of growth of production. The export growth rate was also substantial, being equal to or greater than the import growth

⁵A survey of the data available from the IMF indicates that conceptually uniform balance-of-payments statistics for all sub-periods is not available. However, uniform current account data are available, and they have been used in this article and the accompanying table. In the cases of Belgium and the Netherlands the source data were published in local currency. They have been converted into U. S. dollars at the exchange rate as of December 1965. Because current account data are employed, the average values for each period cannot be used to interpret the strength of the balance of payments. For example, some countries like Italy have a secularly weak current account position which is buttressed by a capital inflow, while other countries like Belgium have a strong current account and a constant capital outflow. However, one can tell the direction of improvement in the balance of payments, assuming that the balance on capital accounts is not changing radically, by looking at the changes in the current account position from period to period.



rate in all countries considered. The balance of payments was nonetheless weak during most of this period because of the sizable excess of imports over exports that existed at the beginning of the period.

Phase II: Lower but Sustainable Growth Rates. For the EEC countries this period extended from the middle of the 1950's to the early 1960's. For Japan Phase II started in the early 1960's and has continued to the present. In all six countries the rate of growth of production was reduced in Phase II, as the special growth stimulating characteristics of Phase I disappeared. In five of the six countries the import growth rate was also lower in Phase II. All of the countries except Japan strengthened their balance-of-payments positions, and these countries are considered to have developed hard currencies during this phase.



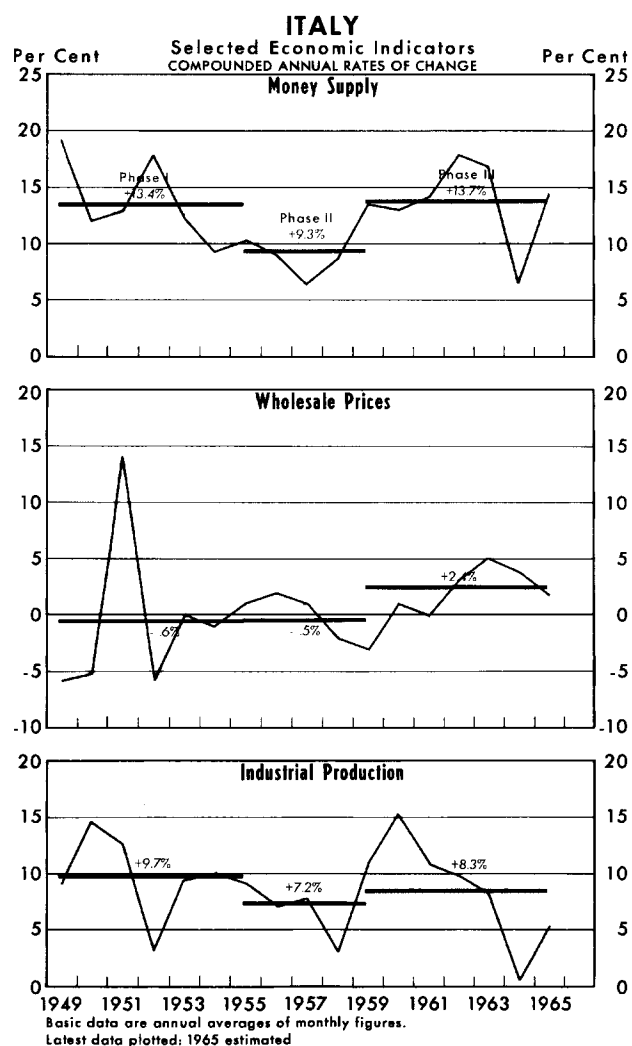
As measured by the growth in money, Japan has been the only country to follow a very expansionary monetary policy in Phase II. This has not been an especially successful policy: the increased demand has not kept the rate of growth in production from falling; it has caused some rises in wholesale prices and sharp increases in consumer prices and has prevented import growth from declining in proportion to the diminished growth of production. Japanese experience supports the generalization that expansionary policies will at least postpone the emergence of a hard currency in Phase II by keeping total demand growing at a faster rate than can be supported by the growth in real domestic product. However, indications are that Japan's present monetary and fiscal policies are less expansionary relative to growth in private demand than they have been in the past.⁶ Under these circumstances the balance of payments is apt to show strong surpluses over the next few years (the current

⁶In Japan, until very recently, private demand was quite strong so that government policy was expansionary when it permitted this demand to be realized by allowing money supply to grow at a rapid rate. An expansionary policy in this sense was followed from 1960 to 1964 by Prime Minister Ikeda. His successor, Mr. Sato, and Minister of Finance Fukuda have criticized this policy and the price increases associated with it.

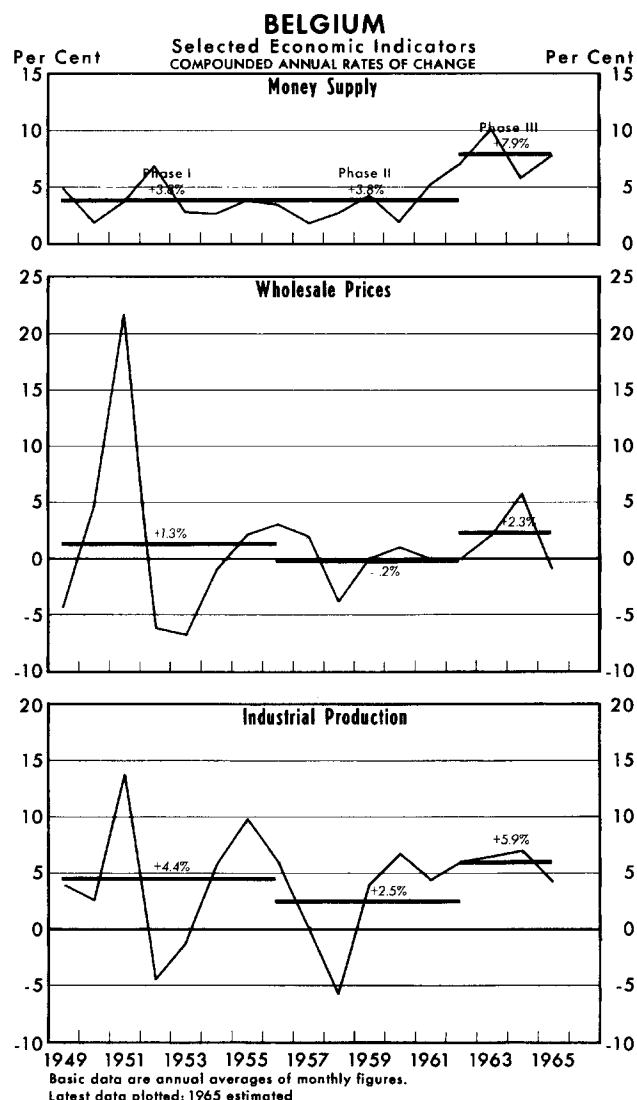
account surplus in 1965 will be close to \$1 billion), and under the definition used in this article the yen could well become the next hard currency in the world.

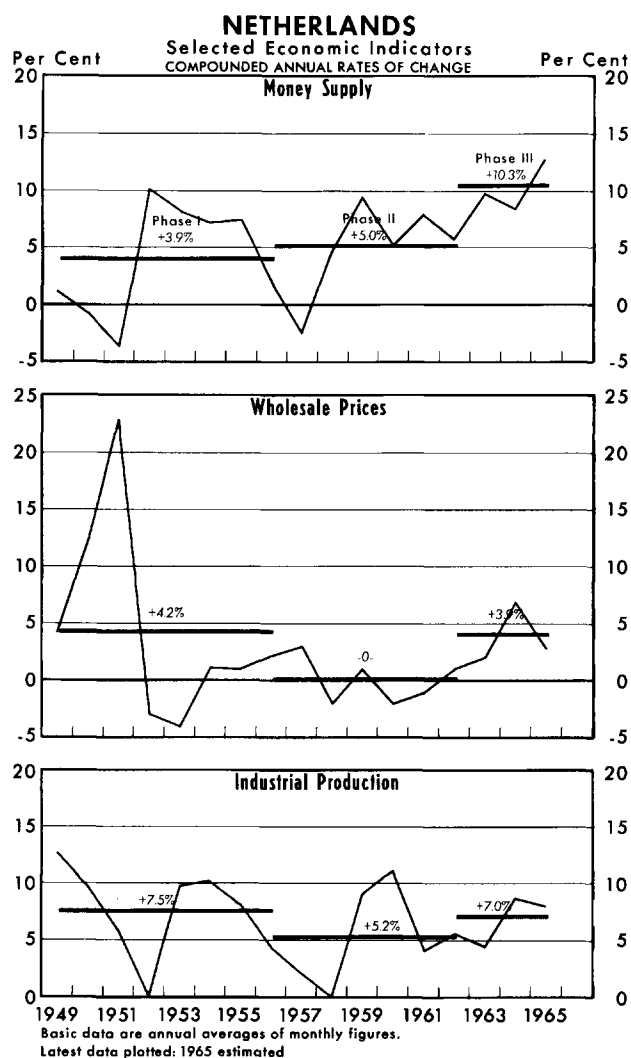
France provides an interesting special case, showing that a change in the exchange rate can compensate for lack of domestic price stability in some cases. In contrast to the other EEC countries, France experienced price inflation during Phase II as well as during Phase I. In spite of this, it developed a hard currency and strong balance of payments during Phase II. This was made possible, to a large extent, by the devaluations in 1957 and 1958 which made its prices more competitive vis-a-vis its major trading partners.

Phase III: Price Inflation and Weakening in the Balance of Payments. This period, which only the EEC countries have entered, started in the early 1960's and has continued to the present. In part because of the strong balance-of-payments positions developed during Phase II, somewhat more expansionary monetary and fiscal policies have been adopted, first in Italy and somewhat later in the other EEC countries.



The major characteristics of this phase have been rises in domestic prices and sharp increases in the rate of import growth associated with only moderate increases in the rate of growth of production. There has been some deterioration in the balance of payments, but because of the continued heavy capital flow into the EEC only Italy has experienced any real problems as yet. It is to be noted that recently Italy drew back from the excessively stimulative policies of the early years of Phase III (perhaps because of the balance-of-payments problems it experienced in 1963 and early 1964) and might in a sense be said to have reverted to Phase II. Because of the reduced rate of price increases it appears that France is also following less expansionary policies throughout Phase III relative to earlier phases. However, this may only be an illusion based on the fact that in France the stabilization plan of September 1963 imposed an administrative price "freeze" on many major industrial prices.

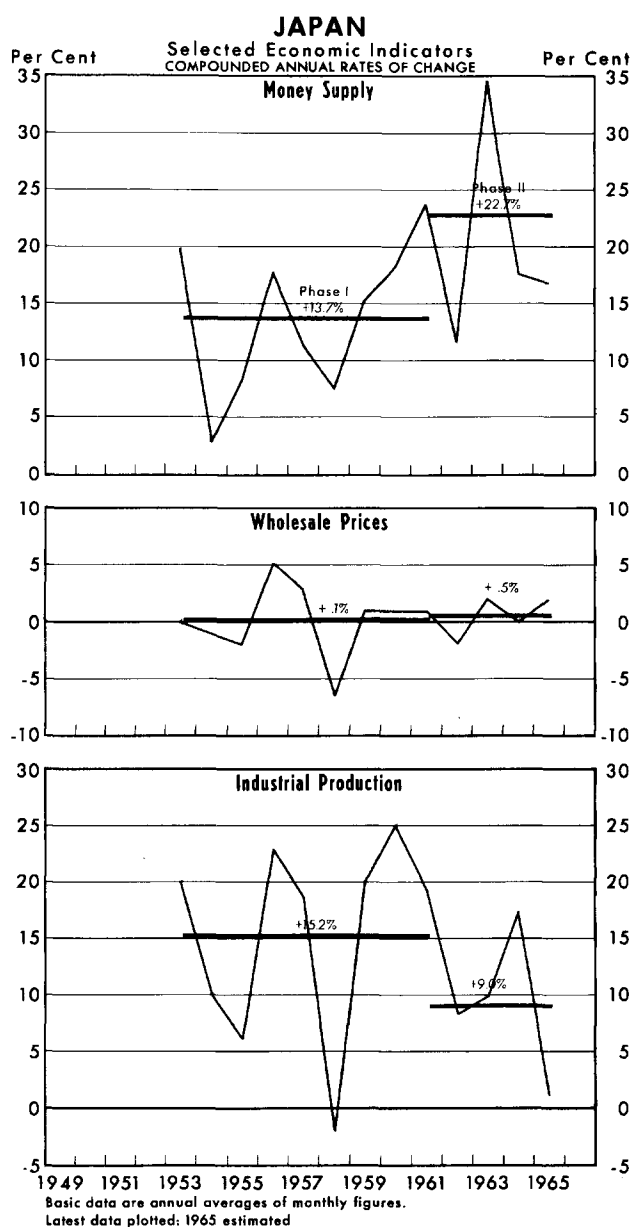




Conclusion

Among the industrial countries of the free world which have convertible currencies, balance-of-payments disequilibrium has become a serious policy problem in the past several years. If the international economic structure as it is presently constructed is to be preserved, it is important that secular payments imbalances be corrected. The reason, of course, is that permanent balance-of-payments deficits cannot be continued without a country's running out of reserves with which to finance the deficits. One of the serious problems which many authorities see in the present international economic structure is the lack of an adequate adjustment mechanism which will insure that over the long run a country's surpluses and deficits will cancel out.

The fear of insufficient flexibility is based on two considerations. First, a great deal of economic and political pressure has been generated toward main-



tenance of fixed exchange rates between important currencies. Second, in the postwar period domestic policy in each country has been directed primarily toward achieving full employment and an adequate growth rate. This means that deliberate deflationary action to correct the balance of payments is unlikely except in those cases when it is also consistent with domestic objectives.⁷

If domestic considerations prevent reduction in the internal price level while the accepted international

⁷There has been considerable discussion recently about the possibility of achieving both external and internal policy objectives with the appropriate mix of monetary and fiscal policy. However, given the institutional rigidities and policy biases in most industrial countries, the appropriate policy mix has not been operative in the period considered in this article.

pattern of behavior prevents changing the price of the domestic currency relative to other currencies, countries with deficits will have no method available for adjusting the values of their currencies to competitive international levels. Of the industrial countries considered in this article, only France has devalued since 1949. Those devaluations adjusted France's international prices for the fact that its domestic wholesale prices had increased at a higher rate than those of its major competitors. This improved France's international competitive position and was of some importance in its later balance-of-payments surpluses. However, the countries with balance-of-payments deficits now are the reserve currency countries, the United States and the United Kingdom, for which devaluation is not a feasible alternative.

Secretary of the Treasury Fowler has announced that the United States is in favor of convening an International Monetary Conference sometime in 1966 to

discuss possible changes in the present system of international trade and finance which would provide for future increases in international liquidity and improve the adjustment mechanism. However, there may be an automatic adjustment process built into the present international mechanism. Those countries which run persistent surpluses also seem to have rising domestic prices. On the other hand, the United States, which has had a persistent balance-of-payments deficit, has had remarkable price stability. The combined effect of these price movements is in the direction of reducing the balance-of-payments surpluses in Europe. Given sufficient time, this may be enough to ameliorate payments imbalances. However, even with this element of flexibility, there is still a question whether the present international financial system can continue to operate in the future with only slight modifications toward increased liquidity.

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