

the United States a better market in which to buy and the United Kingdom a better market in which to sell. U.S. exports, therefore, will be stimulated while imports will be retarded.

8. Generalizing the illustration, changes in exchange rates, by inducing short-term capital movements, by making it profitable to ship gold, and by changing the relationship of exports to imports serve to distribute the world's gold among the nations in accordance with their needs and to prevent prices in all countries from getting out of line with each other. This is what economists mean when they refer to the "automatic equilibrium under the free gold standard."

It should be emphasized that the correctives under the free gold standard are freely fluctuating foreign exchange rates, the freedom to buy and sell gold, mobility of prices, and relatively free international movement of merchandise. The prices of the factors of production—wages and profits—are affected little, or not at all.

International balance under conditions of inconvertibility

Two World Wars and a major economic depression have shattered this world payments system. Currencies are no longer based on a free gold standard, but are "managed" in that the quantity of money and credit in circulation is determined by the fiscal and monetary policies of governments and central banks. The nexus between commodity price levels and gold has been broken. Monetary gold is now used only to settle international balances. Even international settlement is a matter of government policy. In practice, the U.S. Government buys gold at the fixed price of \$35 an ounce and sells it at the same price to foreigners, on demand. The U.S. dollar is not freely convertible into gold domestically and the United States is no longer on a free gold standard.

As long as countries operated under the free gold standard they were not conscious of the balance of international payments because payments and receipts were never far out of line with each other. Now that the automatic correctives of the gold standard are no longer operative, however, countries watch their international payments with a keen eye so as to be in a position to intervene whenever weakness develops, meaning by "weakness" a tendency for outward payments to exceed receipts from abroad.

A country's balance of international payments is a barometer of its economy vis-a-vis the outside world. Adjustments that used to be prompt and near painless under the free gold standard now require considerable effort, time and strain. Strong pressures develop, therefore, to prevent them from occurring. As soon as there are unfavorable developments in a country's balance of international payments efforts are made to "correct" them, usually by preventing adjustment.

If foreign exchange rates were allowed to fluctuate freely there would be a persistent tendency for price levels to adjust to each other through changes in imports and exports of goods and services. Thus, if prices in the United States should rise to higher levels than in the United Kingdom, imports into the United States from the United Kingdom would increase, thereby causing the value of the dollar to fall in terms of pounds sterling. As the dollar falls in value relative to other currencies it would become profitable for foreigners to convert their money into dollars and to use them to buy certain goods in the United States, which would tend to "correct" the rising