prices. This reasoning, which is known as the "purchasing power parity theory" because it emphasizes the attainment of international equilibrium through the adjustment of internal prices rather than through gold movements, probably would work if countries were willing to allow their economies to adjust to each other. However, since adjustments sometimes cause deflation at home by forcing certain wages down, governments resist. The home currency is not allowed to fall on the foreign exchanges and steps are taken to introduce exchange controls, export subsidies, quotas limiting imports, and other devices designed to preserve the status quo. In the absence of a free international gold standard wide variations in uncontrolled foreign exchange rates would make international commercial transactions hazardous and would be a serious deterrent to international trade.

Nevertheless, worldwide abandonment of the free gold standard and freely fluctuating foreign exchange rates has not eliminated the pressure of economic forces to adjust internationally. What has been eliminated is the sensitive mechanism making it possible for national economies to adjust to each other quickly and with a minimum of friction. Although gold is still used to settle international balances it no longer brings the purchasing power of national currencies into line with each other. Prices, wages, and other economic variables are now immediately and directly subject to international pressure and therefore can be out of line with each other for a long time.

The automatic correctives of the old payments system served to insulate the basic factors of production (principally labor) of national economies against each other by absorbing the shocks of adjustment. With these correctives no longer operative the factors of production become more sensitive internationally. When wages and employment have to absorb the shocks of adjustment, there is danger of unemployment, a slowdown in economic growth and economic recession.

It is conceivable that the leading countries of the free world could agree upon an international monetary system that would approach the automaticity of the free gold standard. There was hope, as World War II came to an end, that the United Nations would be able to establish an international currency and a world reserve bank. The most that they could agree to, however, was the establishment of an International Monetary Fund which, though constituting an important step toward international economic stabilization, is an inadequate substitute for the free gold standard.

Under the free gold standard system international gold movements were residual in that gold was shipped abroad to reestablish international equilibrium whenever other economic forces, such as exchange rates, merchandise trade, services, and capital movements failed to balance. Although gold is still used to settle international balances, it does not now move automatically. At the present time, therefore, gold can be more than a residual item in the balance of international payments. Independent movements of gold, such as those caused during the second half of 1960 by speculation on the free gold market in London, can be a cause, as well as a result, of a deficit in the balance of international payments.