

Admittedly, official discount and Treasury bill rates in several continental countries, for example, Germany, Switzerland, Netherlands, are lower than in the United States, although in Britain they are higher. But the official rates in these continental countries are not as accurate as a guide to market rates open to commercial operators as in the United States, or Britain. In some cases, for example, Germany, the official rates cover a very narrow and rather unrepresentative market, and rates on prime commercial paper are significantly higher than in the United States.

In another case, Switzerland, access to the domestic market is partly restricted for foreigners. A better guide to the relationship of American and European rates is provided by the active market in Eurodollars, which are a means by which North American funds can be loaned to Europe at higher rates than are available domestically in North America, and without exchange risk.

A large volume of funds has been attracted to Europe by the higher rates available there; it appears that the major American source has been from banks in centers, notably New York, with extensive international connections and that banks and firms in other centers have made little use of other facilities.

If they were more widely used, the strain on the U.S. payments position from an outflow of short-term capital might greatly increase, precisely because of the interest rate differential in favor of Europe. At least it seems that it would therefore be unwise to cut rates sharply in the United States, unless European rates fell sharply.

The international capital market is now so unified that no country can, while allowing effective freedom of capital movements, safely allow its interest rates to be far out of line with those in other major centers. Moreover, it seems likely that for some time ahead, shortage of capital will keep European rates relatively high. Indeed, purely on balance-of-payments grounds, there is a case for arguing that American rates should be raised.

I must hasten to add that I would not begin to recommend this as a policy. But this is one way of highlighting one of the major dilemmas of policy in our present international currency system. This system, which finally became established with the restoration of convertibility at the end of 1958, is a restoration of the gold standard as we knew it in the 1920's and before the First World War.

The rules of this system are simple. Each country maintains fixed exchange rates with all other members; except in extreme circumstances, exchange rate charges, beyond very narrow margins, are ruled out.

In order to maintain balance-of-payments equilibrium, those countries find themselves in payments deficit which deficit improves contractionary domestic policies, including high interest rates which also serve as a palliative to the payments deficit by attracting foreign funds. Countries in payments surplus should introduce expansionary domestic policies, even to the point of inducing a degree of price inflation, although this prescription is rarely emphasized by proponents of the gold standard.

The virtues of this system include the maintenance of stable exchange rates and the simplicity of the basic rules. Its major disadvantage, which is well exemplified by the present U.S. situation and