by repeated British experience, is that it may tend to a conflict between the requirements of domestic and international equilibrium. At the moment, domestic considerations suggest that American policy should be expansionary.

But the deficit in the balance of payments suggests that the right policy, under gold standard rules, is one of domestic contraction. The dilemma is emphasized if one considers what would happen if expansionary policies were taken, as suggested above, and demand were increased by, say $30 billion a year. Some of this demand would take the form of a rise of imports; the net effect would be less than this direct effect because the extra demand for foreigners' goods would raise their prosperity and so increase their demand for American goods; but on balance there can be little doubt that the net effect would be a sharp deterioration of the U.S. balance of payments. And if it should happen, though this seems unlikely, that the domestic expansion led to a faster rate of price rises, then the situation would be made all the worse by the reduction in the competitiveness of American exports.

Here, then, lies the source of the present dilemma about policy. Ultimately, there may be a way out, if the competitors of the United States, and Britain, inflate faster than we do so that their exports become less competitive and our balances of payments improve. But, at best, this is likely to prove a fairly lengthy process.

It is the logical basis of current British policy and would be the only logical basis for an American decision to accept a new period of domestic stagnation or a renewed minor recession. The immediate effect of such a policy is a waste of unemployed resources. The longrun effect may also be that the deflation may inhibit investment and innovation and so reduce the potentialities for future growth and for future competitiveness in world markets.

Short of changing the rules of the game and developing an international financial system with greater exchange rate flexibility, which I would consider the most desirable policy, there are still a few things that can be done. Some are already being done with considerable effect, such as the steps taken to reduce Government expenditures overseas.

In addition, action might be taken more forcibly to restrain speculative pressures on the dollar during the period of payments weakness. For example, that part of the gold reserves which is now tied as currency backing might be released; the U.S. reserves are still very large by world standards, in relation to deficits, and it would be worthwhile to take measures such as this to emphasize the fact. Again, the present system of swap agreements, whereby the United States and other countries have agreed to hold stipulated amounts of one another's currencies, might usefully be expanded.

Beyond this, it is desirable to take steps to deal with two interrelated problems which greatly exacerbate the difficulties of working the present gold-standard system. One is the system's dependence on the two key currencies—dollars and sterling—which serve to act as a substitute for gold, of which the amounts available for use as intercontinental reserves is now quite inadequate, taken alone. The other difficulty is that of the overall shortage of international liquidity.