

Concentrate your monetary weapons on the balance-of-payments problem and take care of domestic problems, if necessary, by fiscal and possibly other measures. If monetary policy is, so to say, mortgaged to the international problems, the logical answer would be a revival of fiscal policy for domestic purposes.

This seems to be recognized by a growing number of international observers. There is a problem of timing, too.

The balance-of-payments deficit is an immediate, and, in view of the surplus on current account, I hope a short-term problem. Stimulating the rate of economic growth, on the other hand, is a long-term proposition and the threat of real depression still seems to be potential rather than actual.

A promising strategy would thus consist, I feel, in fighting, first, a rather short but decisive battle on the external front by restoring international confidence in the dollar. Success on this front will then free forces for the domestic front where the struggle might take much longer.

INTEREST RATES

Such a policy would require somewhat higher interest rates, both on long and on short term, perhaps not for very long but for a certain time. The effects of higher interest rates seem to come in two stages.

The immediate effect is mainly on the balance of payments; European experience seems to show that this effect is quite prompt and strong. This is partly because in a free market money, particularly bank money, goes where it earns the most.

At least as important, however, is the psychological effect, for a tightening of money is taken as a sign that one means business and thus helps to restore confidence. At the moment I am under the impression that it will be very difficult to say the least, to stop the international drain on the dollar without a certain, if perhaps modest, rise in interest rates.

There is, it is true, a second stage where credit restrictions begin to affect domestic demand for commodities, particular housing. In Switzerland this effect of credit conditions on construction activity could be observed quite clearly and I do not want to minimize it. But this effect takes several months, perhaps a year, to be felt, and it could, in principle, be neutralized by appropriate fiscal measures, if necessary.

An effective restoration of confidence in the dollar by a temporary tightening of money may even make it easier to maintain moderate interest rates in the long run.

THE QUESTION OF ALTERNATIVES TO HIGHER INTEREST RATES

Isn't it possible, it may be asked, to solve the present problems without resorting to dearer money, even in the short run? Theoretically there is, of course, the possibility of a devaluation of the dollar. It seems to be generally agreed, however, that this is not a practical solution. In fact, it would be the ultimate expression of the failure to find a solution.

Since in all probability most other currencies would follow suit, there will be no net gain for the dollar. While in some limited sense devaluation would increase international liquidity by making gold do