

eral Reserve, in 1931, with catastrophic effect, applied a large dose of credit restriction to cure a speculative outflow of gold. Each of these policies was applauded as eminently correct by adherents of the soundness approach, but very little applauding was being done by anyone a few years later when the country was enjoying their cumulative effects.

With the eventual development of prosperity and the dimming of these memories, the soundness doctrine seems to have arisen again. Again, it sees soundness exclusively in policies that are deflationary: "Defend the dollar by economic restriction, accept the discipline of the balance of payments, fund the Government debt, do not 'force credit upon the economy' and avoid 'sloppy money,' balance the budget in bad times as well as good."

It is difficult to see policy discussion in perspective without recognizing the existence, the historical lineage, and the essentially emotional basis of the soundness approach. One dimension of policy controversy involves whether we shall approach matters in a businesslike and pragmatic way, realistically appraising the probable effects of alternative policies, or whether we shall invoke an emotional formula that sees moral virtue in policies that lead to deflation.

DOES INTERNATIONAL COOPERATION REQUIRE U.S. DEFLATION?

The free world does need an orderly system of international trade and finance. If a U.S. policy of continued deflation of incomes and high unemployment were the only way that such a system could be maintained, doubtless we should be willing to make the sacrifice, and the free world would be willing to suffer the resulting impairment of our capacity for leadership.

Actually, the situation seems to be quite the reverse of this. The rules of the game that would call for U.S. deflation are an unreasonable and illogical set. Solidifying them will only multiply the damage that they will do before they are, as ultimately they must be, discarded. Rather than invoking archaic formulas for deflation, the United States should be contributing imaginative and creative leadership to the development of an international financial system that will make sense and will prove viable in the long run. Our fulfillment of this responsibility recently seems to be somewhat wanting.

Let us consider the essential elements in our problem. We assume that the deficit in our balance of payments and the corresponding surpluses in the position of other countries may be of a fundamental and persistent character. If they were taken to be purely temporary and subject to reversal, the proper course would be simply to let our gold flow out to reduce our liquid reserves. That is what liquid reserves are for. If we lack the courage ever to use them, they are of no value to us.

If the disequilibrium in international payments appears to stem from fundamental causes, then there are six major types of measures for correcting it: Devaluation of the dollar, appreciation of the currencies of countries experiencing balance-of-payments surpluses, tightening of U.S. trade restrictions and controls on capital export, easing of the trade restrictions and capital controls of countries experiencing surpluses, restriction of incomes and reduction of wages