

In certain cases, policy in this country—which is of special importance for the rest of the world—has to operate in a direction that is not in the interests of the rest of the world. If the rest of the world is undergoing considerable inflationary pressure, and the United States is in a state of depression, then the United States will have to expand its financial policies, especially its fiscal policy, in order to improve employment, while using some restraint on the use of monetary policy because of the disequilibrium in the balance of payments.

But one case is very clear cut, where the appropriate U.S. policy is completely in harmony with the interests of the rest of the world. That is the case when the United States has inflationary pressure and when the rest of the world is also experiencing inflationary pressure. In those circumstances, no matter what the deficit in the U.S. balance of payments is, tighter monetary and fiscal policies need to be followed in the United States.

In 1965 we could fault the Europeans for their failure to use fiscal policy, but we certainly have to fault the U.S. monetary policy for an excessively rapid expansion which greatly exacerbated the burdens of financial adjustment on European countries. For the past 5 years they have been allowing a rate of inflation that is not in their own interests, but they have acceded to that policy, allowed that policy to continue, partly because they could not do much about it, and partly in the interests of international adjustment. To make the adjustment effective European prices have to rise relative to American prices.

Well, now we have got into a box. The box is that U.S. policy has been too expansionary, and this has harmed European policy as well; clearly a reversal of policy was in order. Now, that reversal of policy was undertaken abruptly about 2 months ago, when the Federal Reserve System sharply restrained its open-market purchase policy. It reduced the rate of expansion of reserves to the banking system, and caused a tight money squeeze on the economy with consequential effects on the stock market and the bond market.

Sudden reversals of policy are extremely dangerous. It would have been better to have been more restrained in the previous year while following a tighter fiscal policy. But all that is water over the dam. The problem now is that the reversal of policy that is taking place in the United States is inevitably going to have effects on world credit markets, and especially on the weak reserve currency, the pound sterling.

In the event of a devaluation of sterling, an increase in gold hoarding or a run on the dollar, begun either in the private markets or through the central banks, is a serious likelihood. There are perhaps three consequences of such a catastrophic event.

One is that the United States has to suspend operations in gold, which will force the countries in the rest of the world to adopt a dollar standard, continuing to buy up whatever dollars are necessary, as Messrs. Despres, Salant, and Kindleberger have argued.

A second possibility, which is also likely if there is disorganization, is a rise in the price of gold which could come about sporadically with sequential devaluations in various countries. Of course, a third alternative, a dramatic coordinated monetary policy on the part of all the central banks to stabilize the price of gold would be the best.