

ments is subjected, and this in turn diverts policy attention and instruments of policy to the restoration of external balance. Second, it slows down the process by which national authorities, each acting on its own, are able to reach domestic objectives. Third, the response to greater integration can involve the community of nations in counter-acting motions which leave all countries worse off than they need be. These difficulties are in turn complicated by the fact that the objectives of greater economic integration involves international agreements which reduce the number of policy instruments available to national authorities for pursuit of their economic objectives. This article touches on all of these facets of higher economic interdependence among industrial nations, both as fact and as objective, but its principal focus is on the third complication—the process of mutually damaging competition among national policies.

There can be little doubt about the great growth in international economic interdependence over the last two decades. Import quotas in industrial countries have been virtually abolished on trade in manufactured products, tariffs have been reduced, and transportation costs have fallen relative to the value of goods. At the same time, the accumulation of capital and the spread of technology have made national economies more similar in their basic characteristics of production; comparative cost differences have apparently narrowed, suggesting that imports can be replaced by domestic production with less loss in national income than heretofore. Whether a country imports a particular good or exports it thus becomes less dependent on the basic characteristics of the economy, more dependent on historical development and on relatively accidental and transitory features of recent investment decisions at home and abroad. An invention in one country may lead to production there for export, but the new product will relatively quickly be produced abroad—or supplanted by a still newer product—and possibly even exported to the original innovating country.

Monetary disturbances, too, are likely to be much more quickly translated into changes in the volume of exports and imports than they were formerly. Under fixed exchange rates, greater than average monetary inflation in one country will invite a more rapid deterioration in the balance on goods and services than was true in the past.

Enlargement of the decision-making domain of the world's great producing firms results in the rapid movement of capital and technical knowledge across national frontiers, thereby contributing to the narrowing of comparative cost differences; but their activity will also quicken the speed with which trade adjusts to new sales opportunities because they have direct knowledge of foreign markets and access to distribution channels.¹

Finally, as financial markets become more closely integrated, relatively small differences in yields on securities will induce large flows of funds between countries. Banks will increasingly number "foreign" firms among their prime customers: the advantages of inexpensive credit to firms in countries with ample savings and well-functioning financial markets, such as the United States, will be shared increasingly with firms elsewhere.

All of these changes in the characteristics of the international economy during the past decade—and it should be emphasized that economic integration is still far from complete—are crucial to the functioning of the international payments system and the autonomy which it permits to national economic policy formation. These changes mean that in normal periods prospective imbalances in international payments—imbalances which would arise if countries did not respond to reduce them or did not adjust policy measures to forestall them—are likely to be more frequent and of larger amplitude than they have been in the past. "Disturbances" arising from new innovations, from generous wage settlements leading to price increases, and from excess or deficient domestic demand will affect the balance of payments more perceptibly. Whether or not imbalances also last longer depends upon the relationship among the "disturbances:" if they are well distributed among countries and tend equally toward deficit or surplus, the duration of prospective imbalances may well be less than in the past; otherwise it may be longer.

These changes suggest that balance of payments difficulties are likely to be more common in the future, and that they will worsen as the structural changes continue in their recent trend. By the same token, however, correction of im-

¹ A quick response assumes the absence of collusive agreements on price, market-sharing, and the like.