may continue to exert a strong influence on purely domestic decisions. This is true, for example, not only of short- and long-term interest rates, but also of liberal tax benefits to investment, generous depreciation allowances, lax regulation of corporate activities and a host of other measures designed to influence corporate location. It is also true of foreign trade: generous credit arrangements or credit-risk guarantees for exports may encourage total exports without improving the trade balance if other countries are pursuing similar measures.

This feature of policy instruments—that the absolute level of the instrument may have important effects domestically, but that only the level relative to that in other countries influences the balance on trade or payments—raises the question: where do the values of these instruments finally settle? International capital movements between two otherwise isolated countries will presumably be roughly the same whether interest rates are at 7 per cent in one and 5 per cent in the other or at 4 per cent in the first country and 2 per cent in the second.[16] In each case the differential is two percentage points. But what determines whether "community" interest rates settle at the higher level or the lower one? The effects on other objectives may be very different. Economic growth will be inhibited more in the first case than in the second.

This would be of secondary importance if all countries had many policy instruments at their disposal. Each country could compensate for an deleterious effects on domestic objectives arising from the value of instruments determined predominantly by the community as a whole. But as we already noted, the number of instruments and the range of values they can assume are often sharply limited by tradition or law. Indeed, it is highly likely that at any point in time a country will have as its disposal *only* the minimum number of policy instruments that it needs to satisfy important domestic political demands. Policy instruments affect the welfare of particular members of the community as well as national economic objectives, so their use will be resisted. Public expectation is that certain measures, while theoretically conceivable, will in practice not be used. Any attempt to invoke them therefore meets stiff resistance.[17]

The values which policy instruments take on in the community of nations, and the process by which those values are reached, are therefore of strong interest to the individual nations. They may not have sufficient domestic flexibility to offset the damaging effects of policy instruments which are forced to an inappropriate level by international competition among governments. As a result, greater international integration can force choices among national objectives which otherwise would all be attainable.

There are occasions in which most or even all members of the international community will find themselves worse off. The competitive devaluations and tariff wars of the interwar period offer the most striking examples; many of the proscriptions in the GATT and the IMF Articles of Agreement are designed to avoid a repetition of those events.

But competition among policies was not thereby banished on all fronts. For example, interest rates shot upward in 1965 and 1966 to levels one to two percentage points higher than those which had prevailed in most countries in 1964. Some of the increases were designed to curb domestic demand; others were defensive, to limit capital outflow. Even after domestic economies had cooled down, it took a dramatic meeting of finance ministers at Checquers, England, in early 1967, to reverse the process. Four other types of policy instruments having these characteristics have been used in the effort to strengthen the balance of payments of various countries: restrictions on government procurement, government-sponsored export promotion, tax incentives to domestic investment, and changes in domestic tax structure. The United States, faced with large payments deficits during the early sixties, made or considered moves in all of these areas: but in each case there was ample precedent abroad for doing so.

Government purchases for government use are specifically excluded from coverage by the GATT rules governing international trade.[18] The result is that a

---

[16] This must be qualified to the extent that interest rates influence total savings in two countries.

[17] The inflexibility of potential policy instruments is summed up in the adage. "Any *old* tax is a good tax." Changes in taxes not only affect marginal decisions—that may be the objective—but also capital values which the marketplace has adjusted to allow for the old tax. Thus changes in taxes often result in capital gains for some and capital losses for others.

[18] GATT, Art. XVII(2).