

involved (a GNP of over \$750 billion, compared with balance-of-payments deficits of between \$1 and \$4 billion a year) that the difficulty does not arise from economic weakness. It is, rather, evidence of inability, or lack of willingness, of countries to allow their economies to adjust to each other through the free flow of capital and merchandise trade.

Ordinarily, a country having persistent deficits in its international accounts must either increase its international receipts, relative to its payments, or allow the foreign exchange value of its currency to decline. Prior to World War I there was an international monetary mechanism that kept the values of national currencies in line with each other, namely, the international free gold standard.

THE FREE GOLD STANDARD

What made the free gold standard system of the 19th century so effective was the manner in which continuing equilibrium in the international accounts was maintained. There were no persistent deficits, or persistent surpluses, in the balance of international payments of Great Britain or any other important country. So effectively, in fact, did the Bank of England function as world banker that the system seemed automatic and natural.

In those days most international trade was carried on in terms of pounds sterling. Pounds and gold were freely convertible into each other, and other currencies were convertible into pounds or into gold. The international balancing mechanism seemed to be so close to automatic that countries were not even conscious of imbalances between their international receipts and their international payments.

Gold was free to move from country to country, not by virtue of governmental decisions or licensing but in response to market forces. The freedom of gold to move internationally, together with the willingness of most countries to accept the discipline of the gold standard, by allowing bank credit to expand and contract as the supply of gold expanded and contracted, provided the world with a multilateral payments system that worked well. International commerce was free, not in the sense that there were no trade barriers, but in the sense that tariffs were applicable to all foreigners alike. There was no discrimination against certain suppliers in favor of others through the use of quantitative import restrictions and other trade controls.

The pound was convertible into gold at a fixed rate and the currencies of most countries were freely convertible into each other. Currencies were legally defined in terms of their gold weights. The dollar was 23.22 grains of fine gold and the British pound sterling was 113.0016 grains. The ratio of the weights of the two currencies (4.866-plus to 1) was known as the "par of exchange."

Individuals could convert gold into currency, or currency into gold, at the legal rate, or convert one currency into another at the prevailing exchange rate. Gold was the standard of value and the system provided a mechanism for keeping the values of currencies in line with each other at approximately their gold parities. As a result, gold was distributed throughout the world according to need, as determined by changing prices and by changes in foreign exchange rates.

For example, when prices of certain commodities in the United