I therefore disagree with Mr. Roosa when he says, "All of us should give the highest priority in 1967 to closing the gap in the basic balance of payments," and I disagree with the New York Times editorial on January 23 entitled "The Persistent Deficit," which applauded Mr. Roosa's remarks and criticized the President for not playing up the balance of payments in his state of the Union message. The President was right. The war in Vietnam and poverty in the United States are far more important issues today than the balance of payments.

THE IMPACT OF THE BALANCE OF PAYMENTS ON MONETARY POLICY

Mr. Roosa foresaw the need to keep short-term interest rates high in the months ahead as a means of holding foreign short-term funds in this country. I disagree. Part of the reason is the different view of the balance of payments already set forth. In addition, however, we have a different interpretation of how the international capital market works. My view is given in a submission to the Joint Economic Committee's compendium entitled "Contingency Planning for U.S. International Monetary Policy,"[1] especially pages 60 to 62, and I can be brief. In general, the view is that monetary policy in the United States operates over the Atlantic Community as a whole, with certain exceptions like Great Britain, where dealing in the Euro-dollar market on an uncovered basis is restricted. Just as the action of the Federal Reserve System is tightening interest rates in November 1965 and July 1966 raised interest rates in Europe, so the reversal of Federal Reserve policy in September reduced them. The recent reductions of the discount rates in Germany and Belgium were required by the fall in market rates brought about by a reduction of negative reserves of member banks in the United States.

With joined capital markets, and even with capital markets imperfectly joined, somewhat separated as they are by the interest equalization tax, Gore amendment, V.C.R.P., and restrictions in Europe, monetary policy should be made jointly. Secretary Fowler's participation in the meeting of January 22, at Chequers with other finance ministers to lower interest rates is to be applauded—although there is something to be said for using the regular OECD machinery of Working Party No. 3 and not leaving out important parties to the decision. In the long run we need an Atlantic Open-Market Committee rather than a Federal one. But at the same time, the international capital market remains dominated by New York. If foreign central banks raise interest rates, it affects the spread between New York and their market; if New York changes its rate, it alters the whole level. Without denigrating the importance of Chicago or the European financial capitals, the same asymmetrical relationship obtains between New York and Europe as between New York and Chicago, although in lesser degree. The link, of course, is the Euro-dollar market.

For this reason, the United States has much more freedom than European countries to adjust its level of interest rates to its domestic needs. We should set these rates, as I have suggested, cooperatively.

[1] "Contingency Planning for U.S. International Monetary Policy," statements by private economists submitted to the Subcommittee on International Exchange and Payments of the Joint Economic Committee, December 1966.