Internal—External Conflict

Limitation to the domestic sphere, however, is inappropriate. There are international flows on both capital and current account. Because in a reserve currency country these flows usually do not lead to reserve changes for the banking system, and because in the United States they are in any event small relative to the domestic money supply, it has been customary to write money multipliers in a form strictly applicable only to a closed economy. With increasing international mobility of capital, and with the heavier use of gold to settle United States payments deficits, international leakages must be taken into account. For most foreign countries, of course, this has always been the case.

In a world of near-perfect mobility of capital, the outflow of reserves, resulting from the appearance of an interest rate differential, would depend, on the supply side, upon the relative magnitude of reserves and, on the demand side, upon the interest elasticity of demand for money at home and abroad. The adjustment would be instantaneous. The outflow of reserves, if any, reflecting a current account deficit, would depend on the response of income to changing money supply, and on the marginal propensities to import and export, both at home and abroad. This adjustment inevitably would occur with a lag. If these difficulties are overlooked by assuming that the relationships are the same in all countries, and by disregarding the asymmetry introduced by the gold exchange standard, the expanding country's reserve loss is determined by the ratio of its (domestic commerical bank) reserves to those of the entire world. The familiar money multiplier could then be written as:

$$\Delta M_H = \frac{\Delta R\left(1 - \dfrac{R_{RW}}{R_{RW} + R_H}\right)}{r_H(1 - c_H) + c_H}$$

Where R = Reserves
M = Money = Currency + Demand Deposits
RW = Rest of the World
H = Home
c = Currency/Money
r = Reserve Ratio

For most countries with stable and convertible currencies, the term