

the great trading countries to establish an international monetary system that would exert strong pressures to avoid inflation and deflation. The bases for such an international monetary system already exist, although it is necessary to recognize them and to make them effective. The conditions for international monetary stability may be summarized as follows:

- (a) A strong and well-balanced pattern of international payments;
- (b) Stability in the U.S. index of wholesale prices;
- (c) Balance of payments adjustment without inflationary or deflationary bias;
- (d) An adequate but not excessive growth of monetary reserves.

*Pattern of international payments*

It is a remarkable fact that the monetary authorities are much more alert to the threat of instability of the exchange rate than to price and cost inflation. In the 20 years since the end of the war, there has been an almost uninterrupted inflationary drift in Europe and North America. The monetary authorities of these large industrial countries have been disturbed by the steady rise of prices and costs. But they have not been disturbed enough to take forceful measures to stop the steady erosion in the value of money. On the other hand, the danger to sterling implicit in the serious balance of payments deficit has finally led to determined measures to halt the inflation in the United Kingdom. The stability of prices and costs in the United States from 1958 to 1964 was due at least as much to concern about the balance of payments and the international position of the dollar as to the more basic problem of stability of prices.

The emphasis on stability of the exchange rate rather than on stability of prices and costs is difficult to explain. In part, it is a holdover from gold standard concepts. Somehow, people believe that if the exchange rate is maintained, if the gold parity remains unchanged, the currency can be regarded as stable. In fact, of course, stability of the exchange rate may mean no more than that the rate of inflation in one country is about the same as the average rate of inflation in other large trading countries. The monetary authorities may console themselves that their country is doing no worse than other countries in holding down the inflation of prices and costs if it does not have a balance of payments problem. Unfortunately, that is not enough to assure stability of the price level, even if it is enough to maintain the foreign exchange value of the currency.

The importance that is still attached to stability of exchange rates can be a powerful force for inducing countries to avoid an inflation of prices and costs, at least at such a rate as to impair their competitive position in world trade. Thus, if all of the great trading countries were to maintain a well-balanced pattern of international payments, they would exert at least a limited degree of mutual discipline to compel each other to stay in step on prices and costs. Obviously, in such a system, the behavior of the balance of payments of the United States is of preeminent importance. This is partly because of the magnitude of the U.S. economy, partly because of the role of the dollar as the pragmatic standard for all currencies. For most countries, the test of the success of their monetary policy is the achievement of stability in their exchange rates with respect to the dollar.

The role of the dollar in the world economy is so great that no country can find an acceptable alternative to maintaining a close link to it, that is, an exchange rate that is stable in terms of the dollar. There have been a very few instances—only three in recent years—in which countries have appreciated the value of their currencies relative to the dollar in order to minimize the inflationary effect of rising prices in the United States or the expansionary effect of a payments surplus arising from the U.S. deficit. The appreciation of a currency in terms of the dollar inevitably creates competitive difficulties for their exports that countries would prefer to avoid. In the absence of very critical conditions few countries would decide to appreciate their currencies in terms of the dollar. Between the choice of stable exchange rates, relative to the dollar, and stable prices, nearly all countries would ordinarily feel impelled to choose stable exchange rates.

This does not mean that countries would be willing to accumulate dollars as reserves to an indefinite extent or to submit to constant inflationary pressures merely to retain an historical parity with the dollar. Some countries, no doubt, would opt to remain with the dollar under any conditions. But others, and they include some of the largest trading countries, might decide that they cannot risk the subordination of the management of their monetary policy so completely to the uncertainties created by a U.S. balance of payments that remains indefi-