

claims and other credits are necessary for international trade and finance. Because private claims and credits are treated symmetrically, net reserve transactions are a better method of measuring the U.S. payments deficit. In fact, the monetary expansion in other countries caused by the U.S. payments deficit is equal to the reserves that foreign central banks acquire, including their net claims on the IMF. The investments that their banks and companies make in liquid dollar assets actually prevent an expansion in their domestic money supply.

The only means of creating an environment of international monetary stability is a strong pattern of international payments. That is one in which all of the great trading countries would balance their payments on an average of good and bad years, with cyclical fluctuations in surpluses and deficits limited to that level which assures a return to balance when the conjuncture changes. For the United States that would mean a zero deficit, on a reserve transactions basis, measured by a moving average of four or five years, and a surplus or deficit within this period ranging from about plus \$1.5 billion to about minus \$1.5 billion. Such a balance of payments for the United States would require monetary discipline in this country and it would compel monetary discipline in other countries that want to maintain the dollar exchange rate for their currencies.

Price and cost stability in the United States

While a strong balance of payments in the United States is the *sine qua non* of an orderly international monetary system, it is not of itself sufficient to assure international monetary stability. Even a well-balanced pattern of international payments may be accompanied by creeping inflation all over the world. If there is to be international monetary stability, it is also necessary to have stability of the index of wholesale prices in all of the great trading countries. Although it may be difficult for governors of central banks and for ministers of finance to follow rigorous fiscal and credit policies solely on the grounds that it is necessary to avoid inflation, they may succeed in getting support for preventing a rise in prices and costs on the grounds that this is essential for maintaining stable exchange rates. But this will be true only if the United States, whose currency provides the pragmatic standard for exchange rate stability, succeeds in avoiding inflation. The blunt fact is that inflation in the United States will mean world-wide inflation; and price stability in the United States is indispensable to international monetary stability.

There are many countries highly dependent on exports and imports that do a very large proportion of their trade with the United States. For these countries, prices in the United States become embodied in their domestic price level through the prices of export and import goods. But even countries that do only a moderate amount of trade with the United States find that U.S. export and import prices set a competitive standard that affects their price behavior. The fact is that when prices are rising in the United States, producers in other countries find that the compulsion to hold down their own prices is very much weaker and the environment for raising their own prices is very much more favorable. And when prices are stable in the United States, producers in other countries know they must hold down their own prices or risk the loss of their markets at home and abroad. In this sense, stability of prices in the United States exerts a disciplinary influence on prices in all other countries.

When wholesale prices of domestically produced industrial goods and labor costs per unit of output in manufacturing are stable in the United States, any country that allows its prices and costs to rise will find that its trade balance will be impaired. This is evident in the rise of the trade surplus of the United States from less than \$1 billion in 1959 to \$6.7 billion in 1964. The only reason that this did not put greater pressure on European countries to take similar action to stabilize their prices and costs is that the large outflow of private capital and U.S. Government grants, credits and other expenditures prevented the great rise in the trade surplus from converting the U.S. payments deficit into a payments surplus. Once the U.S. balance of payments is restored, there is no doubt that the stability of prices and costs in the United States will compel other large trading countries to maintain a similar degree of price and cost stability.

Nor need there be any doubt that the United States can and will maintain stability of prices and costs. The long-run history of the United States is one of monetary stability, not inflation. Except in periods of war, wholesale prices in the United States have been remarkable stable—more stable than in any other country with the possible exception of Switzerland. Although wholesale