

inflow, as a debt incurred in order to finance a deficit. Unfortunately, we usually lack the information required for this distinction.)

To reduce or remove a deficit by *real adjustment* is to induce such changes in relative prices and incomes as will alter the allocation of real resources and cause such changes in the international flows of goods and services as will improve the current account to match the balance on capital account and unilateral payments. We distinguish aggregate-demand adjustment, cost-and-price adjustment, and exchange-rate adjustment.

Real correctives influence the international flow of goods and services through selective impacts on particular goods, industries, or sectors. *Financial correctives* influence the international flows of private capital funds. *Corrective management of government transactions* may affect government expenditures, loans, and grants to other countries.

REAL ADJUSTMENTS

Economists trained in the classical or neoclassical tradition—the present writer included—have a deep-seated prejudice in favor of real adjustment: (1) It relies largely on market forces rather than selective “interventions” by the state; (2) it is more likely to operate without discrimination, avoiding differential treatment of particular industries or firms; and (3) the chance of its working, of achieving its objectives, is greater.

On the other hand, practical-political considerations militate against real adjustment: (a) Policies to check the expansion of aggregate demand are apt to reduce business activity and employment; (b) policies to check increases in wage rates and prices are resented by some of the strongest groups in society; and (c) policies to adjust foreign-exchange rates are opposed by leaders in business and finance, here and abroad, for reasons good and bad; most understandable is the opposition abroad to a successful adjustment in the flow of goods and services, since it would hurt the business of some of the industries abroad.

Aggregate-demand adjustment is not without advocates among practical men: some highly respected bankers here and abroad advise the United States to “put its house in order” and “halt inflation;” and they intimate that this can be done by means of higher interest rates, higher taxes, and economies in government programs.

Their practical advice is unexceptionable if it refers merely to avoiding inflation of incomes and prices. As a matter of fact, high interest rates, higher taxes, and budget cuts are badly needed to prevent a further deterioration of the imbalance of payments. But it would be far too optimistic to expect that containment of further expansion would restore external balance, especially since the major industrial nations of Europe are likewise pursuing anti-inflationary policies, some even more successful than the United States.

If the conservative advice goes beyond mere avoidance of inflation and suggests in effect that aggregate demand in this country be *reduced* to such a level that our imports fall and exports rise sufficiently for the export surplus to match all other outflows of dollars—then the advice is not acceptable. A deflation of such force could have well-nigh catastrophic consequences for domestic employment and world trade.

Real adjustment by means of demand deflation in the United States is out of the question; adjustment by means of demand inflation abroad is not likely to be accepted, nor would it be advisable. Now, if the adjustment of levels and structures of costs and prices cannot be expected to occur either through reductions in the United States or through increases abroad, the only remaining possibility of real adjustment lies in alignments of foreign-exchange rates. Yet, the resistance to any moves in this direction seems too strong to allow it to be contemplated. I shall, however, not be inhibited and will return to this only chance for a workable adjustment.

PARTIAL DEVALUATIONS

Among real correctives the policies most appealing to advocates of selective measures are what I have for years called “disguised partial devaluations of the dollar.” Open and uniform devaluation being ruled out, measures are recommended to reduce the value of the dollar for particular purposes or in chosen sectors of the economy.

The United States has resorted to such makeshifts several times. For example, it devalued, not formally but in effect the dollar used for foreign military expenditures. This was done by trying to save foreign exchange whenever the cost of buying at home was at first not more than 25 per cent, later 50 per cent, above