

1.5 per cent of GNP. The transfer gap varied only between 0.3 per cent of GNP (in 1951, 1957, and 1966) and 1.2 per cent (in 1950).

The smallness of these figures is most impressive. For it shows what minimal transfers of productive resources in the economy from domestic industry to export industry would suffice to achieve full adjustment. That we should have been incapable of achieving it seems to indicate that anonymous forces involving market prices and incomes can be strong enough year after year to frustrate the aspirations and expectations of this wealthy nation. I hope my observation will not be mistaken for a plea to restrict the forces of the free market. It is meant, on the contrary, as a warning that these forces should be treated with more respect.

THE NEW BALANCE-OF-PAYMENTS PROGRAM

After seven years of unsuccessful corrective measures, the Government has now embarked on a new program. It is, again, not a program to promote real adjustment in the economic sense; instead, it relies on selective correctives operating on hand-picked items of the balance of payments. The President, the Secretary of the Treasury, and the Council of Economic Advisers hope that the country will save at least \$1 billion by a "mandatory program" to restrain direct investment abroad and to bring home larger parts of foreign earnings from past investments; another \$500 million by a "tightened program" to restrain foreign lending by banks and other financial institutions; another \$500 million by discouraging "non-essential travel outside the Western Hemisphere"; and again another \$500 million by reducing the foreign-exchange cost of keeping troops in Europe.

In summary, \$1.5 billion are to be saved by financial restrictions, \$500 million by a corrective measure operating on the private demand for foreign travel, and \$500 by corrective management of government disbursements abroad. The last of these may turn out to be the only continuing saving, if troops are brought back from Europe or if compensating payments are received from NATO allies. The other \$2 billion are nothing but stop-gaps.

Even if the three stop-gap measures succeeded in improving the balance by the full \$2 billion, and even if this improvement eliminated the deficit for the time the restrictions are in force, it would not restore balance; it would only suppress imbalance. As soon as the restrictions are lifted, the deficit will reappear, for there is nothing in the program that has any adjusting, remedial or curative effects. The demand for foreign travel will not be reduced over a long period by restricting for a few years the chance of satisfying it. The flow of capital funds from this country to Europe is determined by relative incomes, prices, profit rates, interest rates, and saving ratios. None of these underlying conditions is altered by the restrictions. The flow is likely to resume, perhaps even to broaden, when the restrictions and prohibitions are taken off.

But that these selective controls are only temporary, and that they have no lasting effects, is not all. An additional question arises concerning the effects that they will have even temporarily. The possibilities of substitution and of repercussions must not be disregarded. Permitted outflows may be substituted for the prohibited ones, and repercussions in the trade balance may offset some of the savings achieved in the selected items. I shall presently provide explanations for these warnings. But I must first deliver myself of an observation on the principle of restrictive measures.

As one who has lived many years in Central Europe under all sorts of prohibitions, restrictions, and controls, I have always admired and loved the supposedly indomitable spirit of freedom in this great country. It is a traumatic experience to see the lighthearted sacrifice of several freedoms with the adoption of the program of payments restrictions. I would never have thought that this wonderful country could sink so low as to impose restrictions on foreign travel.

SOME THEORETICAL EXPLANATIONS

But now I must make good on my promise to present explanations for my skepticism concerning the effectiveness of the corrective measures. The explanations are theoretical, but I hope they will not appear esoteric or specious.

I shall use as illustration the restriction of direct investment, which is intended to save \$1 billion a year.

There are two extreme positions concerning the effectiveness of such a corrective measure. At one end is the opinion that a reduction of a financial transfer, say by \$1 billion, will leave all other items in the payments balance unchanged