But there are too many other factors in the picture to permit anyone to come up with a reliable forecast. Nobody knows, for example, what will happen concerning movements of foreign capital. This item can change either way and in very substantial amounts.

None the less, I believe that conclusions of a qualitative sort can and should be drawn. The two conclusions on which I feel pretty sure are the negative and regrettable ones concerning the effects of the restrictive program. There will not be an improvement of the payments balance by $2.5 billion, as the Administration seems to hope. And whatever improvement will be achieved by the program, it will be only temporary and will not contribute to the adjustment process, will not bring us closer to a solution of our problems.

The widely believed excuse that our military expenditures abroad, chiefly those connected with the war in Viet-Nam, are too large to permit balance in our payments to be achieved, is not justified. Our total financial transfers, inclusive of military expenditures, have been between 2.3 and 1.5 per cent of our GNP. This is a modest drain on our resources. There is no reason why a nation should be unable to accomplish a real transfer of such magnitude.

Adjustment of the balance of goods and services to make the real transfer match a financial transfer of around two per cent of GNP is not an impossible task, provided the adjustment process is allowed to work. I agree that we must not try to do it by depressing domestic incomes and prices. I am afraid that we must not expect our major trading partners to help us sufficiently by means of inflations of their income and price levels. But I see no reason other than superstition and timidity why we should not try to achieve the required relative reduction of our income and price level through adjustments of foreign-exchange rates. The rate adjustment that would achieve the needed adjustment of the trade balance is quite modest and should be negotiable.

I must safeguard myself against misinterpretation. If I speak of adjustment of exchange rates, this does not mean devaluation of the dollar in terms of gold. I do not believe either the desirability or the inevitability of an increase in the price of gold, and I shall explain this position presently. So let no one confuse exchange rate and gold price.

I shall not make the mistake of discussing the problem of adjustment independently of the problem of confidence. This, I am sorry to say, is hardly discussed in the *Economic Report*. Let us turn to it.

## THE CONFIDENCE PROBLEM

I have stated what is meant by the confidence problem: it lies in the danger of massive switches from holdings of dollars to holdings of gold, with a destruction of monetary reserves in the process.

The first distinction required for analysis of this problem is that between private and official holders.

### HOLDERS AND SWITCHERS, PRIVATE AND OFFICIAL

The distinction is important chiefly because of differences in motivation. Private holders of assets make their decisions mainly in their own interest—which includes, of course, the interest of their firm or their family. Official holders make their decisions in what they conceive to be the interest of their country; by definition, they are politically motivated, which may imply that their considerations of the putative national interest are fused with consideration of their own chances for re-election, re-appointment, or popular acclaim.

The differences in motivation can mean that official holders may refrain from switching from dollars to gold while private holders decide to switch, or the other way around, even if their expectations of future events are the same. On the other hand, massive gold purchases by private dollar holders can induce monetary authorities to act similarly even if their expectations differ. For when private purchases of gold result in losses of gold and in accumulations of dollars by central banks, the authorities may convert these dollars into gold merely to restore the previous composition of their reserves. And if these conversions make a heavy dent in the gold stocks of the United States, some official holders may find it prudent to increase the metallic portion of their reserves.

The virulence of private speculation in gold became apparent in December 1967, when the United States within four weeks lost almost $1 billion of its gold; and this despite the fact that other monetary authorities gave up some of their gold and increased their dollar balances. There is nothing under present arrange-