gradually supplementing it with some new source of international liquidity. The key to this proposition is that the official dollar price of gold must be held at $35 an ounce.

Holding these beliefs, I am deeply concerned by recent policy developments at home and abroad. The world is in the process of turning full-square away from the policies of liberalizing trade, investment and travel which have contributed so importantly to prosperity and growth during the postwar period. The road we and other industrial nations are now traveling can lead only to successive, and cumulative, policies of restriction which will surely jeopardize our prospects for prosperity, economic growth and high employment.

Yet I believe there is still time to turn back to the high road of liberalism. The most urgent requirement is that the United States pursue policies which will deal effectively with the fundamental causes of our balance-of-payments deficit, and make the temporary set of direct controls to which we have resorted truly temporary. At the same time, we need to seek the cooperation of other nations, particularly those in persistent balance-of-payments surplus. It will be extremely difficult, if not impossible, for the United States to eliminate the deficit if other nations cling to policies which bring them payments surpluses. And we must avoid actions on our part, such as quotas, border taxes and other devices, which provoke retaliatory actions abroad.

In the situation as it existed at the close of 1967 the United States had to come up with a program strong enough to reverse the deterioration in our external payments. To be convincing, the program probably had to include direct controls over private investment as well as restrictions on overseas travel. But controls of this character are in no way a lasting answer to our real problems. They do buy time, at a heavy cost. If this time is used wisely to mount programs which deal effectively with the basic causes of our deficit, the cost may be justified. But if the temporary improvement they are bound to produce is used as an excuse for inaction on fundamental matters, the consequences for the United States and the world economy could be extremely serious.

Our balance-of-payments problem stems from two basic sources: domestic inflation and heavy government overseas commitments. It is our failure to face up to these problems that underlies the erosion in confidence in the dollar. While there is no questioning of the vast wealth and strength of the United States, there is a growing feeling abroad that we will take the easy way out, through an increase in the price of gold, rather than making the hard choices required to get our domestic house in order and tailor our international commitments to our ability to finance them.

I believe that, for both domestic and international reasons, the United States must move to contain inflation. From the end of 1958 to the end of 1965 we had a remarkable period of price and cost stability. Our competitive position in world markets improved, and our basic trade surplus widened. In contrast, we slid back into inflationary habits in 1966 and 1967, and the inflationary spiral is accelerating this year. As a result, our trade surplus shrank from $6.7 billion in 1964 to less than $4½ billion last year. Unit labor costs in manufacturing, which on the average had been stable in the years 1959 through 1965, have gone up more than 7% since the end of 1965.

The root-cause of this inflationary upsurge lies in the enormous rise in federal defense and non-defense spending after mid-1965—an increase at annual rates of over $45 billion in cash outlays, of which defense accounts for $24 billion. In the absence of a major tax increase, the federal cash deficit soared into the $20 billion plus range. The process of financing these huge deficits without pushing interest rates even higher involved Federal Reserve policies which supported an increase in the supply of money and credit of some 15% last year.

Under the precepts of both the new and the old economics, the combination of large federal budget deficits and rapid increases in the supply of money and credit, at a time of low unemployment, will yield inflation. And the inflation will be aggravated, and made more intractable, by an upward spiral in wages and salaries. Postwar experience shows clearly that the average of wages and salaries goes up at a rate equal to the advance in productivity *plus* the increase in the cost of living. So the initial demand-pull inflation leads to an upward cost-push spiral which will keep spinning so long as it is financed.

If this process is not halted it threatens to undermine both domestic prosperity and our balance of international payments. Inflationary policies involve heavy risks of creating a boom that could lead to a severe slump. As inflationary psychology spreads, it enhances the incentives to build inventories, expand