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# INTRODUCTION AND SUMMARY

Policies for the appropriate adjustment of imbalances of payments, in connection with policies for international liquidity, have been widely discussed since the end of World War I. Prior to that time it had been assumed that the gold standard provided the necessary adjustment mechanism automatically. In recent years the issue has acquired a particular urgency and has attracted a great deal of attention. However, in contrast to the intensive investigation of the liquidity issue, there have actually been very few studies of the state of adjustment policies. In view of the importance of this area for the conduct of international economic relations by the United States as well as other countries, the National Bureau has chosen adjustment policies as one of the topics for analysis in its program of international economic studies.[1]

This report investigates the recent pattern of balance-of-payments adjustment policies. Determining the pattern of policies in actual use is an essential part of evaluating the policies, arrangements, and institutions needed to improve the international monetary mechanism and assure an optimal flow of international transactions. In particular, the experience of other countries may help to indicate the potential of various policies which the United States might employ, in its effort to reconcile maximum utilization of economic capacity and a rapid rate of growth with the compelling need for balance-of-payments adjustment.

The over-all plan of the study, of which this is a preliminary report, is twofold. First, each individual country will be analyzed separately in order to identify the policy reactions in the country. Following this, a synthesis of the individual studies will be attempted, in order

[1] See Hal B. Lary, *Problems of the United States as World Trader and Banker*, New York, National Bureau of Economic Research, 1963; particularly pp. 113–117.

to search for any general pattern, or patterns, in the international monetary system as a whole and to analyze the reasons for similarities or differences among countries.

This latter part, or over-all study, will take up such questions as whether the policies undertaken to adjust deficits and surpluses in the balance of payments are symmetrical to each other, or whether deficits and surpluses provoke different kinds of reactions; whether or not countries employ any strategy or strategies which assign certain policy instruments to balance-of-payments adjustment while reserving others for domestic targets; whether any general change in the policy pattern was discernible over the period under consideration; and if variables such as the size of trade or recent experiences with inflations and depressions explain differences in policy patterns among countries. Other questions of a similar nature will also be investigated.

It must be emphasized that the study of individual countries is subordinated to the ultimate purpose of an over-all analysis of the international monetary system. The separate studies will thus follow a uniform method, making it possible to incorporate them into a wider analysis later. In the process, much specific information about each country will inevitably be lost. In particular, each individual study does not purport to be a comprehensive description and analysis of all the policy actions taken by the country in question to adjust balance-of-payments disturbances. Such a comprehensive study of any single country would require much more attention than could be given to individual cases in an analysis of the present nature. In the present study, the individual patterns are, rather, presented with the aim of demarcating the most salient features of the system. This approach involved selecting certain policies for observation and excluding others: it led to a concentration on aggregative monetary and fiscal measures, with only scant attention to other policies. The study may thus be described as being, essentially, the identification and analysis of the pattern of use of financial policies for balance-of-payments adjustment.

It is, basically, a statistical undertaking. The analysis is aimed at discovering causal connections in one direction: from imbalances of payments to policy measures. It starts out with the assumption that, over time, a consistent association in the occurrence of a certain development, or position, of the balance of payments (or of any other economic target), with the movements of a policy variable indicates a causal relationship rather than a coincidence. The study of time series of variables which indicate balance-of-payments disturbances and those which represent policy instruments may thus reveal the policy reactions—be they automatic policy responses or ad hoc decisions—to imbalances of payments. The investigation of possible associations is conducted by a number of methods; all of these are rather crude, primarily owing to the small number of observations in each country and the large coverage of the study. Yet in combination they appear to yield meaningful results.

The present paper is an interim report on the over-all study. It discusses, in Chapter 2, the methods and techniques of analysis, the meaning of balance-of-payments "disturbances" and their identification, the nature of the policy variables used for adjustment and the interpretation of an adjustment policy, and the possible limitations of the study, its major deficiencies, and the qualifications which must be attached to its conclusions. Chapters 3, 4, and 5 present, as a sample, the analyses of three countries: Japan, Germany, and the Netherlands. At this stage of reporting, no similar sample could be offered of the analysis which will follow in the final report. International comparisons and implications for the international monetary system as a whole must await the completion of all the intended individual country studies.

Of the three countries presented here, one—Germany—does not appear to have conducted any systematic policy of balance-of-payments adjustment. During about half of the period covered—throughout most of the 1950's—Germany had a practically uninterrupted surplus in its balance of payments. Yet economic policy does not seem to have responded by taking an expansive direction—a response that would have been required to restore balance-of-payments equilibrium. The continuous and substantial accumulation of foreign-exchange reserves was apparently regarded as a favorable development rather than as a disturbance which should be corrected. In other periods too, fluctuations in the balance-of-payments position do not appear to have triggered adjustments of policy measures with any consistency. In Germany financial policy thus seems to have been unresponsive, by and large, to balance-of-payments developments.

In Japan and the Netherlands an entirely different pattern is revealed. Here, monetary policy appears to be geared quite closely to fluctuations in the balance of payments. The working of the monetary mechanism is not entirely similar in the two countries, but they share two major elements: the discount rate and money supply react in a consistent way to balance-of-payments disturbances. In times of a deficit, the discount rate is raised and the rate of expansion of money supply tends to fall; with balance-of-payments surpluses, the tendencies are reversed. These are responses which work in the direction of balance-of-payments adjustment. Although changes in the discount rate are of course decided upon directly by the respective central banks, the changes in money supply take place automatically as a result of movements of foreign-exchange reserves. Commercial banks partly offset the automatic impact on the credit basis by increasing their borrowing from the central bank when foreign-exchange reserves fall and repaying their debts when reserves rise. In the Netherlands, this offsetting is even helped by a policy of lowering the minimum-reserve ratio of commercial banks when the balance of payments is in deficit, and raising the ratio at times of surpluses. Both in Japan and in the Netherlands, commercial bank credit thus fulfills only a minor role in the adjustment process, and central bank credit even tends, almost invariably, to move contrary to the direction of movement of foreign-exchange reserves. By some definitions, this may be termed a "disadjusting," or "neutralizing," monetary policy, yet the discount rate and money supply do tend to move in an adjusting direction. By the definition suggested in this study, this outcome amounts to an adherence to the classical "rules of the game."

In neither Japan nor the Netherlands does fiscal policy appear to be attuned to balance-of-payments adjustment. In all three countries, fiscal policy is apparently considered a tool which cannot, or should not, respond to balance-of-payments fluctuations. Nor does fiscal policy appear to form generally part of a policy "mix," by which domestic targets are assigned to fiscal policy whereas monetary policy is reserved for balance-of-payments adjustments, although a few episodes in Japan and the Netherlands do tend to follow this pattern. In the main, the principle of a balanced budget was followed in all three countries, and budgetary policy does not appear to have been generally used for short-term targets.