The Responsiveness of Demand Policies to Balance of Payments: Postwar Patterns

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1971
NATIONAL BUREAU OF ECONOMIC RESEARCH
NEW YORK
DISTRIBUTED BY
COLUMBIA UNIVERSITY PRESS
NEW YORK AND LONDON

L. C. Card No. 76-117954
Printed in the United States of America
ISBN-0-87014-221-6

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2,005,948

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Michaely, Michael.

The responsiveness of demand policies to balance of payments: postwar patterns. New York, National Bureau of Economic Research; distributed by Columbia University Press, 1971.

xviii, 299 p. 23 cm. (Studies in international economic relations, 5)

Includes bibliographical references.

1. Balance of payments. 2. Foreign exchange problem. 3. Economic policy. I. Title. (Series)

MATERIAL SUBMITTED BY PUBLISHER.

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FOREWORD

The postwar era is essentially one of fixed foreign-exchange rates. Since the late 1950's, it is also an era of largely free international transactions. This combination has inevitably made the maintenance of the present international financial system dependent on the use of international reserves and on the adoption of appropriate adjustment policies when balance-of-payments equilibrium is disturbed. While the problem of international reserves has attracted much attention, particularly in recent years, empirical analyses of adjustment policies have been, it seems, underrated in comparison.[1] One is thus inclined to agree with Meade's statement that:

> I am saddened at the sight of so many people in such positions of great responsibility, and in such positions of intellectual and academic influence in these matters, spending such a high proportion of time discussing the differences—which I admit are very important, between the various ways of controlling and increasing international liquidity—relative to the proportion of time which they have given to what in my view is the much more important problem of how the countries in the free world—the developed, industrialized, liberal countries of the Atlantic community, if you like—adjust their payments to each other.[2]

It is this relatively neglected subject matter—the postwar pattern of response of policy measures to imbalances of payments—to which this study is devoted.[3] Determining the pattern of policies in actual use is an essential part of evaluating the policies, schemes, institutions and manuals of conduct needed to improve the international monetary mechanism and assure an optimal flow of international transactions. A system of fixed and stable exchange rates—like the one existing

[1] Probably the most inclusive effort to redress the balance is represented by the recent work of the OECD's "Working Party 3."

[2] J. E. Meade in *Monetary Reform and the Price of Gold,* Randall Hinshaw, ed., Baltimore, 1967, pp. 121–22. Quoted also in Samuel J. Katz's review of the volume, *American Economic Review,* September, 1968, p. 1022.

[3] An interim report of this study has been published as Occasional Paper 106, *Balance-of-Payments Adjustment Policies: Japan, Germany and the Netherlands,* New York, NBER, 1968. The present volume incorporates, with rather substantial changes, the contents of that report.

today, whether explicity or tacitly—requires for its long-term maintenance a given manner of responses to imbalances of payments. The analysis of actual patterns of policies in view of this requirement would thus be indispensable in the examination of the degree of consistency, or stability, of the present international monetary regime.

This volume is divided into two parts. In the first (Chapters 1 and 2), the study's purpose and approach are outlined, and the findings pertaining to the system as a whole are presented. In the second part (Chapters 3 through 12), the experiences of nine countries are analyzed individually. The study was actually conducted, of course, in the reverse order. First, each country was analyzed separately to identify the policy reactions in the country. Following this, a synthesis of the individual studies was undertaken, in order 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 part takes 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.

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 thus follow a uniform method, making it possible to incorporate them into a wider analysis. In the process, much specific information about each country is inevitably 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 imbalances of payments. 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, specifically, to a concentration on aggregative monetary and fiscal measures, with only scant attention to other policies.

This study is, basically, a statistical undertaking. Conclusions about patterns of policy reactions are reached in an "objective" fashion: that is, they are inferred from policy actions, rather than from statements about policy motivations. This may, perhaps, create the impression that the statistical inferences presented here are the sole possible source of evaluating policy responses. In fact, of course, many policy makers are quite articulate, offering very often published explanations of the policies followed. Moreover, other analyses of policy conduct, particularly in individual countries, are rather common. Such statements and analyses have been paid attention to, in the present study, mainly as a means of suggesting possible hypotheses and of checking the study's findings. References to relevant literature, had they been made at every occasion, would have made the presentation very cumbersome. The text of this volume thus avoids, by and large, such references. Instead, a bibliographical list of pertinent publications for each of the countries studied is appended at the end of the country's chapter; and a list of references which are not restricted to single countries appears at the end of Part I.

The wide scope of this study inevitably imposes severe restrictions upon its execution. From a variety of potentially useful methods of investigation, some must be selected and others neglected. The coverage of a large number of countries and the need to force the country analyses into the same mold, so that their findings would be useful as raw material for the international synthesis, led to much compression—and possibly oversight—in these analyses. The present study should therefore be viewed as having largely an experimental nature. It does not purport to provide definitive answers but to suggest probable and tentative conclusions and, hopefully, to provoke other studies of the issue; these—following different routes, employing different techniques and, in particular, examining more thoroughly the experiences of individual countries—may conceivably yield different conclusions or suggest alternative interpretations.

A considerable amount of data had to be assembled for this study. All of it came from published material—partly from well-known international sources (such as the *International Financial Statistics*), and partly from publications of the individual countries. Much of the data was found in the source in the form required for this study, while certain compilations had to be performed for other parts of the data.

Due to the vastness of this material, it is not presented in this volume. But the data for each individual country, as well as descriptions of the sources and methods, can be obtained from the National Bureau.

I am greatly indebted to those individuals whose help and advice were given to me throughout the course of the study. My chief recognition and gratitude are owed to Hal B. Lary, whose constructive comments and congenial criticism contributed heavily to the substance, shape and form of the study, and without whose continuous involvement and concern the study could not have materialized. The early stages of the study benefited from the help of a distinguished Advisory Committee, consisting of Peter B. Kenen (Chairman), Arthur I. Bloomfield, J. Marcus Fleming, George Garvy, Gottfried Haberler, Charles P. Kindleberger, Irving B. Kravis, Fritz Machlup, and Robert Triffin. The draft has been substantially improved by the criticism and suggestions received from the National Bureau staff reading committee, composed of Irving B. Kravis, Robert E. Lipsey, Ilse Mintz, and Peter Temin. Among my other colleagues at the National Bureau, many of whom lent a supporting hand, Phillip Cagan merits a special mention. In its final stages, the manuscript has benefited from a review by John Meyer, and by Emilio G. Collado, Robert V. Roosa, and Willard L. Thorp, who served on the reading committee of the Board of Directors. I also wish to acknowledge the contributions made to the studies of individual countries by various staff members of the International Monetary Fund—in particular, Carl Blackwell and Hannan Ezekiel—who were kind enough to comment upon the drafts of these studies.

The main task of compiling and manipulating the mass of the data was undertaken by Maxine Nord. At a later stage, Richard DeFiore helped proficiently in further statistical elaborations. I am indebted to both, as well as to Shmuel Shraier for carrying out most of the compilation of the bibliographic sections, to George Santiccioli for his attentive editing of the manuscript and to H. Irving Forman for applying his masterly craftsmanship, and his patience, in drawing the charts.

Besides staff meetings at the National Bureau, I have had the opportunity to discuss the study in seminar presentations at the University of Chicago, Columbia University, the Hebrew University, M.I.T., Princeton University, Rutgers University, the I.M.F., and the World Bank.

Finally, I wish to acknowledge the financial aid of the National Science Foundation and of the Ford Foundation, which supported the study as part of the National Bureau's program of international economic studies.

TABLE OF CONTENTS

CHAPTER 5: FRANCE

CHAPTER 6: GERMANY

CHAPTER 7: ITALY

CHAPTER 8: JAPAN

CHAPTER 9: THE NETHERLANDS

CHAPTER 10: SWEDEN

CHAPTER 11: UNITED KINGDOM

CHAPTER 12: UNITED STATES

TABLES

CHARTS