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3:00 p.m., June 30, 1969

P.-P Schweitzer, Chairman
F. A. Southard, Deputy Managing Director

Executive Directors	Alternate Executive Directors
E. Asp	S. Jónsson
W. B. Dale	J. S. Hooker
L. Escobar	R. H. Arriazu
R. Johnstone	M. Horgan
A. Kafka	E. da S. Gomes
B. Kharmawan	
P. Lieftinck	T. de Vries
B. K. Madan	S. S. Marathe
E. W. Maude	G. Huntrods
	C. Bustelo
A. Phillips O.	M. A. Sandoval
	B. de Maulde
A. Z. Saad	A. Mansour
G. Schleiminger	L. Fuenfgelt
J. O. Stone	G. P. C. de Kock
H. Suzuki	S. Hattori
B. Tann	
A. van Campenhout	
	M. P. Omwony
	L. M. Rajaobelina

W. L. Hebbard, Secretary
T. W. H. Eckersley, Assistant

Also Present

Administration Department: P. Thorson, Director. African Department: C. L. Merwin, Deputy Director; E. L. Bornemann, M. Russo. Asian Department: C. C. Liang. European Department: A. Pfeifer, Deputy Director; P. E. Chabrier, H. Duvshani, H. Ponsen, L. M. J. Van Houtven, A. C. Woodward. Exchange and Trade Relations Department: E. Sturc, Director; D. K. Palmer. Fiscal Affairs Department: H. C. Murphy. Legal Department: J. Gold, General Counsel and Director; A. S. Gerstein, Deputy General Counsel; J. G. Evans. Middle Eastern Department: A. S. Gerakis, M. M. Hassanein. Research Department: J. M. Fleming, Deputy Director; C. F. Schwartz, Deputy Director; P. Armington, A. W. R. Braun, J. Chan-Lee, F. Hirsch, B. S. Karlstroem. Treasurer's Department: R. J. Familton, D. Williams. Western Hemisphere Department: J. Del Canto, Director; P. J. Brand. Office in Europe: G. M. Sallé, Director. Personal Assistant to Managing Director: F. L. Hall. Technical Assistants to Executive Directors: H. Bobadilla, G. Castañeda, J. M. Chona, I. A. Craik, P. M. de Raet, R. Patti, H. G. Schneider, J. Skuttle, J. A. Sogo, P. Stek, G. F. Taylor, N. Tsukagoshi, J. R. Vallet, J. C. C. Yuan; K. Stahl, Special Trainee.

1. WORLD ECONOMIC OUTLOOK

The Executive Board met in informal session for a general discussion of the outlook for the world economy.

The Chairman said that a staff paper, entitled "World Economic Outlook" (Buff Document 69/71, 6/26/69) had been issued as background information for the discussion. The views expressed in that paper were not considered Fund decisions, for the paper was simply aimed at fulfilling Executive Directors' requests that there should be some kind of paper on which the exchange of views could be based.

Mr. Schleiminger welcomed the first of the Board's general discussions in informal session on the world economic outlook. He was aware that the Board was embarking on a new experiment whose results were difficult to anticipate. On the other hand, he hoped the experiment would be successful and that the discussions would become part of the established procedure of the Board. He did not think that the discussions would lead to duplication of those held in Working Party 3 of the OECD or in other bodies. The subjects to be discussed by Executive Directors should be related to the Fund's work, and should be regarded in the light of the Fund's interests. While all Directors should feel free to decide what should be reported to their authorities, the main purpose of the discussions, which he hoped would be very frank, should be to keep Directors well informed, and in a good position to understand and interpret actual developments, and thereby better equipped to defend the Fund's interests. He expressed his appreciation for the staff paper, which was a good demonstration of the cooperation between international institutions, since it was based to a great extent on OECD material. But the Board's discussions should not in all cases have to depend on cooperation by the staff; the morning press gave ample material for discussion of current trends. Although an agenda for the discussions was not necessary, it might be useful to note down at the end of each exchange of views the topics which should be discussed at the next session. In that manner, Executive Directors and staff could be well prepared.

The Chairman asked if there were any further comments on procedural matters.

Mr. Kharmawan said that when the question of informal discussions on the world economic outlook had first been raised, he had been hesitant about their usefulness in view of the heavy burden of work facing the Fund, and of the nature of the proposed discussions themselves. He had been doubtful whether anything could be achieved by engaging in academic discussions or expressing pious hopes and wishes. However, having seen the staff paper, he now tended to attach greater value to the informal discussions, because they would probably not be a duplication of what was taking place elsewhere. The title of the paper meant that, in addition to the economies of the highly developed countries, consequences of

developments in those countries on the less developed countries would be touched upon. In other bodies, there were no representatives of a large part of the world economy. In the Fund's discussions, the representatives of the poorer countries would have an opportunity to take note of what was happening in the developed countries and to discuss with their colleagues from those countries the problems of the poorer nations. He was therefore hopeful that the discussions would be very useful.

Mr. Kafka found the staff paper extremely useful, because OECD reports were not always easily available. He hoped that in future the Fund staff could give more detailed information, broken down by continents and regional groupings, of the countries which the OECD categorized simply as the "non-OECD countries."

The staff representative from the Research Department said that the staff had already done some work on the forecasting of trade flows for primary producing countries. The Area Departments had provided the basic data which the Research Department had turned into overall forecasts of exports and imports of groups of primary producing countries. This work would continue, and he hoped that it would form part of some future staff paper.

The Chairman agreed with Mr. Schleiminger's suggestion that, in advance of informal discussions of the kind now being undertaken, Executive Directors should think of specific topics to which a staff paper could be directed. The title "World Economic Outlook" would cover a broad range of problems.

Mr. Schleiminger then turned to the substance of the discussions. He said that he would elaborate on events in Germany since the beginning of May when the German economy had been discussed in the framework of the Article VIII consultation. He had circulated to Executive Directors the English translation of the introductory chapter of the monthly report of the Bundesbank for June 1969, which illustrated the current trends, and facilitated his task. He drew his colleagues' attention particularly to the graphs in that document, and to the table comparing price movements in Germany with those abroad.

Mr. Schleiminger's first comments were directed to the inflow of foreign exchange during the international monetary crisis at the beginning of May. The total amount of the inflow of speculative short-term funds into Germany had been higher than during the crisis of November 1968. The inflow had amounted to about $4 billion, a large part of which was concentrated in one week. Of this total, more than $2.5 billion had flowed out again. The outflow had occurred in two stages: first, immediately after the German decision not to revalue, and second, early in June. While the outflow tapered off after the decision not to revalue at a much slower rate than in November, funds had been repatriated, taking

the first five weeks after the decision as a whole, in higher amounts, both absolutely and relatively, than during the November crisis. That was perhaps somewhat surprising, since in the days immediately following the German decision the outflow was somewhat disappointing. The statement that there had been a more substantial outflow than in November held true even if one deducted from the outflows the funds that had been pushed out by the Bundesbank through its swap transactions with the commercial banks. In addition, the May crisis had also caused a drain on the Euro-currency market; but the flux of funds had been reversed. The explanation for the very high Euro-dollar rates still prevailing on the market could not therefore be ascribed to German policy; while the crisis itself might have influenced the rates, for the period as a whole there had been no net drain from the Euro-currency market. Recently, Euro-currency rates had eased following an announcement by the Federal Reserve. He thought that that might be relevant to the high level of rates prevailing on the Euro-currency market.

Turning to the form of the inflows into Germany, Mr. Schleiminger said that a noteworthy difference between the November and the May crisis was that in May foreign money flowing into Germany had been less in the form of direct foreign placements with German banks than it had been in November. In May a much greater part of the inflow had gone to nonbanking institutions, mainly to business enterprises in the form of intercorporate funds; part of the flow was simply a movement in the terms of payments. Those factors had consequences on the outflow. Bank deposits of nonresidents were the most volatile form of short-term funds. Flows of funds to business enterprises were normally less quickly reversed. Although they were held first in the form of resident bank accounts, they could later be switched into investment in German securities. Movements in the leads and lags were, by their nature, worked off only after a certain period of time, and after the exports for which anticipated repayments had been made had taken place. He concluded that the funds which remained in Germany were the result of changes in leads and lags and would only be worked off over a period of time.

Mr. Schleiminger then turned to the measures taken by the German authorities and referred to his statement at EBM/69/19 (3/21/69), in which he had listed the main measures which had been decided on by the German cabinet at that time, and which were now in the process of parliamentary ratification. Those measures fell into two types: those directed toward future inflows of speculative funds, and those designed to defend international stability and avoid further overheating of the economy. Since that time measures of monetary restraint had in addition been taken, such as the increase in minimum reserve requirements and in the discount rate of the Bundesbank, on which he had reported at EBM/69/43 (6/20/69). The most important of the first group of measures was the abandonment of the provision that the 4 per cent export tax, introduced in November, would come to an end on March 31, 1970. That date had assumed a somewhat uncomfortable character because it had been suggested that it might mark

the date for a possible revaluation. There had been some uneasiness about what the German Government would do on March 31, 1970 in order to deal with the consequences of the ending of the tax on exports. That uncertainty was now removed and the measure would apply indefinitely. The legislation would be passed to the Upper House of the German Parliament at the beginning of July. No difficulties were foreseen in getting parliamentary approval.

Mr. Schleiminger said that the second measure of major importance was the change in the law governing the German Federal Bank, which would receive the authority to impose a minimum reserve ratio of up to 100 per cent of all foreign deposits. Presently, the 100 per cent ratio applied only to the current increases in foreign accounts. The new measure would provide the Bundesbank with greater flexibility in counteracting future speculative inflows, not only because the legal basis for the present minimum reserve ratio on increases was rather weak, but also because the existing maximum ratios on outstanding balances under present laws did not differentiate between domestic and foreign liabilities, thus limiting the action of the Bundesbank, particularly if the 100 per cent ratio on increases were maintained for a long period. Again, this measure was not expected to encounter legislative difficulties, and would come before the Upper House early in July.

Mr. Schleiminger said that measures to curb transactions of a speculative nature had been discussed in terms of imposing a negative rate of interest on foreign deposits. Those deposits were at present interest free, but it had been suggested that in order to give further disincentive to shifting funds to accounts on German banks, a negative rate of interest or a very high commission could be charged. Such measures were still under consideration, but they would create a number of legal difficulties internally as well as externally. Such a discriminatory measure should of course exclude normal credits and deposits made with respect to current transactions. An easier way had therefore been sought, and the banks had offered their good services. It was possible that by a sort of gentlemen's agreement some discriminatory commissions on foreign deposits could be charged. However, agreements of this kind also raised difficulties, particularly in relation to anti-trust laws. Measures of this kind might not therefore see the light of day at all, although they were still under active consideration.

Turning to the fiscal field, Mr. Schleiminger said that the measures had been described as rather mild. That was his opinion also, in the sense that what they achieved was that any future additional tax receipts over and above the budget estimates for the year would not be spent for current expenditure, but would either be allocated to a cyclical equalization reserve, or be utilized to reduce the borrowing requirements of the Federation or the Länder. Thus there would be no real cuts in expenditure or real increases in taxation. Any increase in current revenue would simply be sterilized in some way or another. The financial balance of

the public authorities was not influenced by these measures, which nevertheless had a certain tightening influence and restrictive effect on account of the tightening of bank liquidity in support of the Bundesbank policy of monetary restraint.

In the final category of measures, Mr. Schleiminger included the increase in the minimum reserve requirements, whereby a further DM 2.5 billion of free bank reserves had been blocked. The Bundesbank had now used the margin it had received on account of an increase in interest rates abroad to restrict credit inside Germany and thereby to contribute to the prevention of further overheating in the economy.

Mr. Schleiminger continued by quoting from the Bundesbank monthly report: "For carrying out these measures a certain external margin was available which it was possible to use without having to expect interest-induced money movements from abroad of the same or even greater magnitude, which would frustrate the desired result. It is obvious that in view of the 'open flank' vis-à-vis the rest of the world this way is fraught with risk. It is all the more important that the boom be curbed not so much by the instruments of central bank policy as by such fiscal measures as directly curtail overall demand." He concluded from this that the Bundesbank was still aware that any major restrictive policy would be self-defeating, and that the emphasis of any restraint had to be on fiscal policy because the room for maneuver was limited by the balance of payments.

Turning to the general economic climate in Germany, Mr. Schleiminger said that the boom had continued with full speed in spite of all these measures. As in 1968, the cyclical upswing had centered mainly on investment activity. In addition, consumption was rising rapidly, and foreign demand remained buoyant. Symptoms of overheating were still increasing, such as the backlog of orders, which was now higher than the peak which it had reached during the last boom in 1964-65. In May the number of vacancies had been more than 800,000, while the number of unemployed had dropped to 123,000, corresponding to 0.6 per cent of total manpower. The labor shortage had become the main obstacle to further real growth in Germany, as had been the case in 1964. Substantial increases in productivity had provided the economy with a rather unexpected degree of elasticity, but with 90 per cent of capacity being utilized, productive resources were being used to an even greater extent than during the previous boom. The strain in the labor market, notably the wage drift, was having an increasing impact on the measures outlined on pages 6 to 9. The present boom, which had been characterized by a certain lag in wage movements, might end in a rather large explosion of wages, as a number of important settlements had to be negotiated toward the end of the year when demand would probably be as buoyant as it was now. In spite of forecasts that there might be a slowing down of investment activity, orders, particularly for investment goods, showed no confirmation of that whatsover. Moreover, prices had started a broad upward movement. Industrial producer prices had increased in the first four months of 1969 at the rate of 2 1/2 per cent.

The cost of living in May was 2.7 per cent above the corresponding period in 1968. In general, the authorities had been obliged to make another upward correction in the major macroeconomic projections. The expected increase in gross domestic product was now 5 1/2 per cent instead of 4 1/2 per cent. The gross national product at current prices would rise about 9 per cent in 1969, instead of 7 per cent. That was partly due to a faster increase in real production, but was also due to the fact that the GNP deflator would increase by more than had been expected; it would be 3 per cent instead of 2 1/2 per cent.

Mr. Schleiminger then referred to a table in the Bundesbank monthly report which compared price movements in Germany with those abroad. The table showed that in recent months there had been an acceleration in inflation in Germany. In March 1969 the cost of living had been 2.3 per cent higher than 12 months previously, in April 2.5 per cent higher, and in May 2.7 per cent higher. Nevertheless, these figures were lower than corresponding increases in the cost of living in all the other countries mentioned in that table, except Italy and Sweden. In particular, the rise in other EEC countries had been markedly higher than in Germany. In France, the cost of living had been 6.7 per cent higher in April 1969 than in April 1968, and the corresponding increase in the Netherlands was 8.4 per cent; the greatest price disparity in the Common Market was not between France and Germany, but between the Netherlands and Germany. The price disparity inside the EEC was now at least as great as the disparity with the rest of the world. He noted that the rate of increase in the cost of living in the United States was still double that of Germany.

Turning to the balance of payments, Mr. Schleiminger said that, comparing the first four months of 1968 with the first four months of 1969, the trade surplus of Germany was receding; the figures were DM 5.4 billion for 1968, and DM 4.1 billion for 1969. The current surplus was also smaller, DM 2.1 billion compared to DM 3.8 billion. Thus, in the first four months of 1969 Germany had a current surplus of $525 million. This would give a current account surplus for the whole year of $1,500 million. The contrast was much more striking if one looked at the capital balance. In the first four months of 1968 the net long-term capital outflow had been DM 2.2 billion, whereas in the corresponding period of 1969 the outflow had been DM 8 billion, equivalent to $2 billion. In other words, the basic balance was in deficit in the first four months of 1969 by $1.5 billion. Thus the projected current surplus for 1969 had already been more than offset by the net capital outflows during the first four months. The basic deficit could reach as high a figure as $4.5 billion in 1969 if the capital outflow continued at the same rate as during the first four months, which, however, was rather unlikely. Still, when speaking of the "massive surplus" position of Germany, it was useful to consider the actual figures and prospects. During the first four months of 1969 the reserves of the Bundesbank had declined by more than $1 billion. Although that situation had been changed

by the short-term capital inflows in May, the situation was now becoming more normal. He was reluctant to make predictions about the ultimate outcome of the basic balance for 1969, but believed that developments in the first half of the year showed that at least as far as the basic balance was concerned, Germany would remain in deficit, because he had every reason to believe that the net long-term capital outflow would continue.

Mr. Schleiminger turned finally to questions which had been put to him by Mr. Palamenghi-Crispi on the Bundesbank's interventions in the foreign exchange market. During the May crisis the deutsche mark had on occasions been bought in New York at a price above the limit fixed under the Fund's Articles of Agreement. He explained that the German authorities, had, during the whole period, kept the rate for the deutsche mark vis-à-vis the dollar within the limits defined by the Articles, by intervention with U.S. dollars. This intervention had taken the form either of intervention at the fixing of the actual quotation in Frankfurt or in the form of buying and selling U.S. dollars during the times when the Bundesbank remained in the market, i.e., from 9:30 a.m. to 12 noon and from 2 p.m. to 4 p.m.; he thought that was the normal practice in Continental Europe for official intervention. As far as New York was concerned, the Federal Reserve of New York often intervened on behalf of the Bundesbank, but that was something outside the obligations under the Articles. He recognized that there had been quotations outside the limits in the foreign exchange markets outside Germany.

Mr. Kafka said that he had found the staff paper and Mr. Schleiminger's exposition most helpful and interesting. The basic diagnosis he drew from the staff paper was that, while both growth and inflation were currently rather high in the industrialized countries, a slowdown in growth and a relatively considerable decline in the rate of inflation in 1970 were likely. The unfortunate aspect to this development, which otherwise one would welcome as far as inflation was concerned and consider unavoidable as far as the slowdown of growth was concerned, was the fact that the industrialized countries placed so much emphasis on monetary rather than fiscal policies. He found it particularly interesting to read in the Bundesbank report of the strictures placed on the insufficiency of monetary policy. It was of course a well-established point in monetary theory that freedom of capital movements inhibited the effect of monetary policy on the internal situation. It would affect mainly the balance of payments. This point underwent modifications when one went to such lengths as using various aspects of the interest rate twist, whether that was done in the manner of the United States in the early 60's, or whether it was done--more effectively--by negative interest rates on foreign funds. However, the experience of the United States, and the legal difficulties pointed out by Mr. Schleiminger, showed that such interest rate twists were not easy to bring about. He therefore hoped that before too long there would be second thoughts on the appropriate mix between fiscal and monetary policy in the direction of stressing the former to a larger extent. The overemphasis on monetary policy placed a heavy burden,

resulting from high interest rates, on certain vulnerable sectors within the industrialized countries as well as on the less developed countries. He stressed particularly the problem which the high rates caused for the latter, which, as a result of incurring in the past much medium-term indebtedness from lack of other opportunities, often had to refinance large sums every year; he added that the total indebtedness which they had incurred was generally not outside the limits which would be reasonable considering their export performance. If the refinancing fell due in a year of high interest rates, it would produce effects not only in that year, but for many years ahead when interest rates might have fallen, and at a time when prices of primary products might reflect not only the absence of inflationary but also the presence of deflationary tendencies, particularly in the markets in which the developing countries were most interested; in this way a particularly heavy burden was placed on those countries. He remarked that in some banking systems it was possible to negotiate loans at variable interest rates, especially medium-term loans. He would like to hear from his colleagues about the possibilities in this respect.

Mr. Kafka said that, in addition, the restrictive policies in some countries had a worrisome impact as far as the capital account was concerned. The United States had taken care to isolate the less developed countries from restrictions on capital flows, but it was not possible to achieve a complete isolation. Although Germany had made a great effort to step up long-term capital exports, from which the less developed countries had benefited, the composition of that capital outflow was not entirely desirable.

Even more disquieting, Mr. Kafka continued, was the likely impact on the trade of the non-OECD countries of success on the part of the United States and the United Kingdom in reaching their balance of payments targets. In general, the less developed countries would be hit to a much larger extent than the majority of industrialized countries. These prospects demonstrated the need for decisive measures to stabilize their export earnings. Although the Fund's action in extending the compensatory financing facility appeared to be very nice, nobody really believed that it was going to have much impact. The real need, however, was to help them to escape from their positions as exporters of primary products only. The industrialized countries should grant tariff reductions, and refrain from adopting quantitative restrictions on the exports of manufactures from the less developed countries. Indeed, it would be desirable to grant tariff preferences for manufactured exports. At the very minimum, the industrialized countries should guarantee them against future increases in tariffs. In this way, the poor nations would have a clear future before them and know in what direction they should develop.

Returning to the question of capital flows, Mr. Kafka said that the United States Government was interested in stimulating greater participation of private capital in international assistance to developing countries;

the Germans had also increased their private capital exports to the less developed countries. Those were by no means unwelcome developments, but they posed certain problems in that capital flows were not available for certain purposes, mainly for financing the large overhead expenditures which the governments of the developing countries had to undertake. He said that an interesting possibility in this respect was the fact that the United States had on its statute books a law which empowered the Government to cover loans raised by developing countries by "an extended risk guarantee," which was a far-reaching guarantee. So far this guarantee had been applied only to export credits and suppliers' credits and in a few cases to loans for the construction of low-cost housing. But he understoood that there was no U.S. statute which would prevent the guarantee from being used for the issuance of bonds by the governments of developing countries, which could thereby have access directly to the New York capital market, where they would undoubtedly be able to obtain money at tolerable interest rates. He would have no objection if countries wished to help this sort of development by adopting something on the lines of the Horowitz Plan, or if they treated the underdeveloped countries in the same way as the United States Government treated municipalities, as far as tax exemption of interest was concerned. However, the extended risk guarantee was the most interesting possibility, and could lead to the reappearance of the old bond market which had served the world so well in the late 19th and early 20th century, and to which at present developing countries had access only with great difficulty and at high risk.

Mr. Kharmawan asked the staff for some additional information. He noted the sentence on page 4 of the staff paper which stated that the imports of industrial countries from primary producing countries had swung strongly upward in 1968 and had been some 11 to 12 per cent higher for the year as a whole than in 1967. He asked first, what were the comparable figures for the imports into the primary producing countries from the highly developed countries, and second, how the terms of trade between the two groups had changed.

Mr. Kharmawan then took up Mr. Schleiminger's remarks which, he said, had failed to provide a satisfactory rebuttal to the sentence on page 13 of the staff paper which said that in both Germany and Japan measures to restrain incipient inflationary pressures were likely to be reflected in even higher external surpluses. He asked Mr. Schleiminger to comment on the staff's statement. In addition, he noted that Mr. Schleiminger had mentioned that the world should not worry too much about the German surplus in view of the capital outflow from Germany. Mr. Kafka had already commented on the nature and the direction of the capital outflow from Germany in relation to the primary producing countries. Moreover, he was not sure whether the action of compensating a huge trading surplus with a large capital outflow was, from an economic point of view, the same thing as remedying the surplus ex ante. He thought that the two methods

of dealing with the problem would have different consequences for Germany and the rest of the world. He did not share Mr. Schleiminger's optimistic interpretation of the capital outflow.

Mr. Schleiminger said that the sentence on page 13 of the staff paper to which Mr. Kharmawan had referred should be read in context. In addition, the sentence itself was applicable to all countries which had a strong current account position; any measures of economic restraint would of course be reflected in the balance of payments. In qualification of that observation, he indicated that there was a certain time lag in the reaction of Germany's current balance to the strong economic activity within the country. The current account surplus was going down at a regrettably slow rate, and slower than during the boom of 1964-65. The measures of restraint in order to ward off an overheating of the economy were certain to slow down the process of current account adaptation. Thus the German policy would not lead to even higher external surpluses; but the attempt to control the amount of overheating might slow down the process of adaptation.

Mr. Schleiminger challenged Mr. Kharmawan's suggestion that the German authorities should tackle the problem of the surplus ex ante, and wipe it out altogether. In a highly industrialized country with a savings ratio of 27 per cent, compared with a savings ratio of 17 or 18 per cent in the United Kingdom and the United States, a large capital outflow was a normal part of the structure of the balance of payments. In addition, it corresponded to the internal needs of Germany that part of the savings were invested abroad; indeed, they had to be invested abroad if, given the current account surplus, the total balance of payments was to be in equilibrium over the long run. He wondered what Germany would achieve by balancing its current account, either by means of revaluation of its currency or by an inflationary spiral, thereby leaving no room for foreign aid and capital exports. All the industrial countries, notably the United States and the United Kingdom, had gone through a period when their important current surpluses had been used to finance the export of part of their savings to other countries. Germany was apparently at that stage, which the United States and the United Kingdom had reached at some time in the past. Those two countries were now mature creditor countries and, at least in the case of the United States, were able to finance a large part of their foreign investment by means of receipts from earlier investments. Germany was not yet in that position, and therefore had to earn the foreign exchange in order to make the investments through surpluses in the trade account. He wondered whether it would be in the interests of the rest of the world if Germany adopted a policy of balancing its current account.

Mr. Kharmawan said that his reading of the last sentence on page 13 of the staff paper was somewhat different from Mr. Schleiminger's. His interpretation of it was that the German authorities' measures to restrain inflationary pressures would increase external surpluses, rather than

slow down a reduction in those surpluses. The main reason for this was of course that if domestic demand decreased, more exportable commodities would be available, and, in view of the price differentials mentioned by Mr. Schleiminger, German exports would increase. As far as the second point was concerned, he had in mind not a wiping out of the balance of payments surpluses; rather, the necessity was to reduce the excessive surpluses, in order to avoid the recurrence of the events of May 1969. A recurrence of that crisis would naturally not be conducive to the economic development of the poorer countries which, with a very narrow margin of maneuver, were always harmed by such crises.

The staff representative from the Research Department commented on the final sentence of page 13 of the staff paper. Underlying the view expressed in that sentence was an assumption of a certain set of financial policies. One way of interpreting that sentence was that if the German authorities were to follow financial policies that were tighter than the ones assumed in the projections, then the surplus for 1969 would be higher than the $1.5 billion shown in Table 7 of the staff paper.

Mr. Lieftinck said that the staff paper cast an alarming light on the near future. If the reserve currency countries realized their targets, improving their trade balances to the extent indicated, it was clear that the main adverse impact would be carried by the non-OECD countries, as a result of a strong decrease in the imports of the key currency countries, and the consequential decrease of the non-OECD countries' exports. This would result in a serious recession in a large area of the world, particularly the countries which exported raw materials. That recession would be magnified if in the year 1970 there was a recession in the industrialized countries also; he did not rule that out. The result would be an unhappy world economic situation, of which the non-OECD countries would be the main victims. Although the assumption that the key currency countries would try to improve their trade balances by reducing imports was the most reasonable one, it was also the most unfortunate. Since the results could perhaps be disastrous, another way of improving the trade balances of the reserve currency countries should be considered, namely, the stepping up of their exports. In doing that, they would be serving the world much better than by reducing their imports. It might therefore be helpful for the United Kingdom and the United States to try by all possible means to improve their competitive positions. If that attempt was successful, then the gloomy conclusion of the staff paper might not be realized, and the non-OECD countries might be little affected by the improvement in the balance of payments of the key currency countries. If the competitive positions of the United Kingdom and the United States were to improve considerably, then there was little doubt that they would be able to penetrate further into the OECD, and particularly the EEC markets, unless the latter market closed itself even more tightly than was the case at present. The key currency countries should emphasize policies to reduce internal demand, such as incomes policies, which would set free more resources for

increasing exports. If at the same time they tried to maintain a fair balance in their internal economies, a sharp reduction in the export opportunities of the non-OECD countries would be avoided. In conclusion, he said that while the whole assumption on which the staff paper was based might be realistic, its outcome would be most unfavorable. If the Fund desired to take up a position in this matter, it should be a position which favored a fundamental readjustment of policies and competitive positions.

Mr. Dale commented on the action of the Board of Governors of the Federal Reserve in putting out, for comments within 30 days, proposed amendments to its regulations with respect to borrowings by U.S. banks from their foreign branches. The basic motive for this action was international rather than domestic. It was not the expectation nor the intention that reduction in Euro-dollar borrowings, which would come about as a result of the proposed actions, would to any great degree tighten domestic credit. He quoted the following sentences from the Federal Reserve press release of June 26, 1969: "The reserve requirements proposed in these amendments would remove a special advantage to U.S. banks of using Euro-dollars for adjustment to domestic credit restraint. The Board noted that these reserve-free liabilities of U.S. banks to their foreign branches have risen by more than $7 billion since the beginning of 1969, and by about $3 billion during the first three weeks of June." The reason for the proposed action was to reduce the rates of interest in the Euro-dollar market and to eliminate the difficulties associated with that, and the problems which had affected the official reserves of some other countries.

Mr. Dale said that the most important of the proposed measures was a marginal reserve requirement of 10 per cent on borrowings of U.S. banks from their own branches abroad. The reserve requirement would relate to the amounts by which future borrowings would exceed the daily average amounts outstanding in the four weeks ended May 28, 1969. In order to plug potential loopholes, two further actions were proposed. The first was a marginal 10 per cent reserve requirement on loans by foreign branches of U.S. banks to U.S. residents. That was to prevent the situation in which an American banker at headquarters in the United States sent a customer to borrow from a branch abroad, thus achieving the same result as if the foreign branch lent to headquarters, and headquarters to the customer. Second, a 10 per cent overall reserve requirement was proposed on borrowings by member banks from foreign banks.

Mr. Dale said that the figure of 10 per cent had been chosen because it indicated the serious intentions of the Federal Reserve. The figure was considerably higher than it might have been; for example, the figure for similar requirements in relation to time deposits was 6 per cent. It was intended to go above that figure, to the highest amount that might be applicable to time deposits under present regulations, so as to indicate a desire to have a real impact on the borrowing operations.

The Federal Reserve had not made any prediction of the quantitative effects of the proposed actions. One could calculate the result of the actions on Euro-dollar transactions at given rates of interest, but one should bear in mind the secondary effect that the announcement of the proposal had already had on Euro-dollar interest rates. There could be little doubt that Euro-dollars would be less attractive than they had been in the past.

Mr. Dale said that he had no general comments on the state of the U.S. economy. He expressed hope that the House of Representatives would act affirmatively that day as far as the extension of the 10 per cent tax surcharge was concerned. Price increases were still unacceptably high. The most recent indicator on consumer prices was somewhat less than it had been in previous months, but also somewhat less than it was likely to be in some future months. One would have to wait until the end of the year to see the results of the combination of a reasonably tight fiscal policy with a very tight monetary policy.

Turning to the staff paper, Mr. Dale said that the calculations as to what the implications might be if the United States and the United Kingdom were able to reach their targets, rather than the OECD projections, were very revealing. He asked for clarification of the meaning of the final column in Table 1 of Appendix 1 of the staff paper. He assumed that the domestic action postulated in that column was of a much more severe kind than had been forecast. He wondered what the effects of that would be on other countries. That led him to look at the alternatives of adjustment by means of demand management, and of adjustment by means of price changes. For example, he noted from the table of comparative price changes in the Bundesbank monthly report that the increase in the cost of living in the Netherlands had been very high, even in comparison with the United States. He found himself wondering about the implications of that. For example, it would be interesting to know how the cost of living index compared to the wholesale price index. One would assume that wholesale prices would rise less rapidly than the cost of living index, and he wondered whether the difference between the two indices for the Netherlands was particularly large in view of the Netherlands' good trading performance. That was only one instance of the attention that one must pay to trade-offs in terms of adjusting the trade position by means of relative price changes and by relative demand conditions.

Mr. Dale supposed that the changes which the staff had assigned to the forecasts for the U.K. and U.S. trade balances should be seen as statistically convenient rather than indicative of a belief that changes of that kind would in fact occur. He had been led to that belief by a footnote in the staff paper which showed that a more complicated analytical technique had been tried, in which an attempt had been made to assign changes to both imports and exports, but that broadly speaking the net impact on other countries' trade balances had not come out very differently, and that had led the staff to feel that the simplification used in the

paper was not misleading. However, he agreed with Mr. Lieftinck that everything possible should be done, both by way of general and selective nondiscriminatory policies, to improve the export performance of both the United States and the United Kingdom; but it was unavoidable that, whether the improvement was achieved on the import side or on the export side, someone else's trade balance would suffer.

Mr. Dale then examined pages 13 and 14 of the staff paper. He drew the conclusion from the views expressed on those pages that, given the existing geographic and commodity structure of trade, and given existing policies, adjustments of imbalances through changes in trade positions would be difficult. It also seemed that adjustments by means of changes in, or perhaps even by means of a continuation of, the present structure of capital flows also seemed rather difficult. One should ask the question: what should a country have its eye on when judging what was a sustainable and viable long-term balance of payments equilibrium? In a statistical way, one might simply aim at an official settlement position which was sustainable, and not worry too much about the breakdown between capital flows and current flows. But the staff seemed to take the view that, if in the eyes of most people, particularly the market, the current account seemed to be sustainable over a period of time, then capital flows would tend to be equilibrating.

Mr. Dale acknowledged that the present structure of the U.S. balance of payments with its rather unusual capital inflows, particularly short-term inflows, was not a proper or sustainable kind of equilibrium. He believed that, with the appropriate policies all round, sustainable equilibrium for the United States would involve a current account surplus, probably of fairly substantial magnitude. But he did not rule out the possibility that, because of maturity or other reasons, it might be possible to have a situation of net capital inflow, or at least capital balance. This, combined with current account balance, might be more or less the way in which the U.S. balance of payments would turn out over a period of time. In any event, the question did arise of how many objectives countries should have with respect to the balance of payments. If they had a current account objective, an overall objective, and a trade account objective, there would always be a question of whether enough tools existed to achieve all the objectives simultaneously.

Mr. Dale commented finally on the interesting ideas put foward by Mr. Kafka. His comment on the "extended risk guarantee" took him back to the time when, as a member of the President's Foreign Aid Task Force in 1961, he had shepherded that proposal into the legislative process. It had been considered a radical idea at the time, and was still a radical idea; it was perhaps for that reason that it had not been implemented with the vigor which Mr. Kafka would like to see. The implementation of the extended risk guarantee brought difficult problems. If the full faith and credit of the U.S. Government was to be attached to something other than a Treasury Bill, certificate, or bond, difficulties

arose over questions of debt management with respect to the domestic market for securities. Some people concluded that if it was so difficult to distinguish between, and carefully manage, the different kinds of instruments which were ultimately guaranteed or issued by the U.S. Government, then the U.S. Government should issue all the instruments, and allocate the funds domestically or abroad in accordance with its own best judgment.

The staff representative from the Research Department answered Mr. Dale's question about the final column of Table 1 of Appendix I of the staff paper. He said that the point was that the reductions in the imports of the United States and the United Kingdom would have to be greater than the target changes in trade balances, since the reduction of imports into either country hurt the position of the other. He said that Mr. Kharmawan would find the information he sought on trade between the industrial countries and primary producing countries in the first table of the fourth chapter of the draft Annual Report.

Mr. Johnstone said that he was delighted that the Board was engaged in the first of what he hoped would become a series of interesting discussions. The staff paper was useful, fascinating, and rather frightening. He would return to that after briefly explaining the current state of the Canadian economy.

Mr. Johnstone said that an impressive boom was still continuing in Canada, with very strong first quarter national accounts results. Policy was clearly and firmly set in the direction of controlling this, but evidence was admittedly slow in coming in that the policy had had effects on real and price developments. However, there had been some hints that a slowdown was in the offing. Retail trade had diminished somewhat in the early part of 1969. That was true not only of car sales, but of sales of consumer goods more generally. The unemployment rate had drifted back up to 4.4 per cent in April. Those were indicators that improvements would come before too long. But one had to admit that similar indications had not turned up on the cost and price side. The annual rate of wage increases had drifted down somewhat, but he understood that the latest contracts, particularly in the construction industry, and in the busy parts of the country, such as the Toronto metropolitan area, had begun to rise again to the level of 8 or 9 per cent. Prices were still increasing very rapidly.

Mr. Johnstone agreed with Mr. Kafka's remarks about the relative mix of fiscal and monetary policy. That would apply in some degree to Canada, although perhaps more strongly to certain other countries. The following sentence on page 6 of the staff paper was somewhat charitable: "Among other industrial countries, only a few (for instance, Canada) have so far made an active use of fiscal instruments to counteract overheating." The Canadian authorities were unquestionably using monetary policy a great deal; his own judgment was that the change in the fiscal position from the previous to the current fiscal year had not been what could be called a

dramatic tightening. Nevertheless, fiscal policy was in a distinctly restrictive direction, and the most recent information showed that the targets the Government had set for itself in this respect were being achieved without difficulty. He anticipated that in the months to come the fruits of these policies would be seen in a distinct improvement on the cost and price side.

Turning to the staff paper, Mr. Johnstone welcomed the fact that it contained quantitative predictions, which were crucially important in assisting the Fund to form judgments about where the world economy was going and about the appropriateness of the policies of the major countries. He fully agreed with Mr. Lieftinck's comments about the disturbing implications of the conclusions of the staff paper for the nonindustrial countries of the world. The more one considered the problem, the more likely it seemed that adjustment by sharp cutbacks in the imports of industrial countries would pitch the world into a disastrous situation.

Mr. Johnstone quoted two important sentences from page 13 of the staff paper: "If the United States and the United Kingdom were to reduce imports by the indicated amounts through general contractionary policies, a severe check to their economic growth and rising unemployment rates would occur (along with adverse effects on growth in other countries). If the economic impact of the adjustment on the United States and the United Kingdom were to be alleviated, the major non-reserve currency countries would have to expand aggregate demand considerably above rates that are now expected; this might well be an undesired course of action in many countries because of inflationary pressures." Those sentences prompted him to suggest that the staff paper did not contain an indication of the domestic circumstances which might be associated with the OECD forecasts or with the adjustments to those forecasts suggested by the staff in order to allow for the situation in which the United States and the United Kingdom achieved their targets. This absence of a notion of the domestic implications complicated the job of making judgments, for example, on how much more rapid the growth in certain European countries would have to be in order to achieve the suggested position for the first half of 1970; on how much unemployment would be implied for the deficit countries; and on what price performance might be associated with these domestic developments in various countries. Finally, it made more difficult a judgment on what kind of policy adjustments might be necessary in order to bring about the desired positions in the first half of 1970. He had mentioned this difficult series of questions in order to bring out the point that, in thinking about the adjustment process, one should, of course, consider a much broader set of objectives than those relating to trade balances and current accounts positions. The forecast changes in external positions, set out in column 2 of the table on page 16 of the staff paper, did not seem to be very large. Indeed, he was not sure whether they were outside the margins of error to which this type of calculation was susceptible. But without some kind of analytical link

between the domestic and the external sectors, it was difficult to determine whether that column contained a set of positions which would be difficult to achieve in terms of the domestic objectives, or whether it contained predictions which were just as likely to occur as the OECD projections.

Mr. Johnstone said that even if the U.S. and U.K. targets were achieved in the first half of 1970, even if the trade positions and current account positions of the other major countries were to adjust in the manner suggested in the staff paper, and even if all that could occur without disastrous domestic consequences, then the world would still be a long way from what would generally be taken as a viable and acceptable structure of trade and current account positions. He fully accepted the view that capital flows had a part to play, and he hoped that they would continue to make a positive contribution to the adjustment process. Nevertheless, in looking at the target figures for the first half of 1970, and comparing them with one's judgment of what the external position of major countries ought to be, one had to face the conclusion that there were only two possibilities. The first was that the markets would simply have to learn to live with a structure of payments balances which was quite different from the structure hitherto implied by the major countries' targets. The other possibility was to recognize the need to take before long steps in the direction of bringing about changes in the relative competitiveness of the major trading countries. That might be necessary in order to achieve balance of payments structures in line with the present intentions of the major countries. It was with respect to those conclusions, which went beyond tha arithmetic of calculations for the first half of 1970, that the implications of the staff paper were most interesting and most disturbing.

Mr. Maude said that he had held the view that the Board's recent discussion of consultation papers on France, Germany, and the United Kingdom, together with its forthcoming discussion on the United States, would leave little scope for a useful exchange of views in an informal session of the kind the Board was now engaged in. However, he had found Mr. Schleiminger's description of recent events in Germany very useful, and he thought that the discussion had proved its worth. That was to a considerable extent due to the very interesting staff paper. The staff had been wise to take as its basis the OECD projections. He had compared those projections with a set of forecasts recently made by his own authorities, and had found that although they differed in places, they were not far apart. The general picture given by both those sources was, in his opinion, less discouraging than the picture drawn by Mr. Lieftinck. After making allowances for the U.S. dock strike, which had reduced U.S. trade very sharply in January and February 1969, his general assessment was that world trade had continued to rise during 1969 at about the same rapid rate as in much of 1968. Since special factors such as currency fears had swelled the rise in world trade in 1968, it was likely that the rise would be slower throughout the rest of 1969. Any forecast of that

kind must obviously depend heavily on the assumption that, whatever might happen with respect to exchange rates and in the foreign exchange markets, cooperation in the monetary field would continue, and anything approaching a breakdown of the system would be avoided. One should also assume that there would be no widespread resort to protectionism. Third, it was necessary to make some forecasts about the course of the U.S. economy, where demand had remained more buoyant than had earlier been expected. Although the present was not a fruitful time to try to interpret the current economic indicators, a general expectation existed that the U.S. economy would continue to slow down its growth gradually through 1969 and into 1970, and one could not entirely rule out the danger of a more marked slowdown, even of something which could be called a recession. However, that was less likely than a gentle deceleration, followed in 1970 by renewed expansion. Although the recovery could begin well before the end of 1970, the increase in real GNP might be no more than 2 per cent. In spite of that, the rise in output and imports in 1970 should be almost as high as in 1969, and above the trend rate for the past five years, on the assumption that most governments continued to aim at normal growth. On those assumptions, it was reasonable to put the rise in world trade at something in the area of 8 per cent, a little below the average rate of growth in recent years. That picture could turn out quite differently if, for example, there was in fact a recession in the U.S. economy in the early part of 1970. That would mean a sizable fall in U.S. imports, which would have psychological consequences, as well as consequences on world trade. The OECD Secretariat appeared to expect that the slowdown in the United States would be relatively short lived. The judgment of his authorities was that the OECD might exaggerate the speed with which the turnaround in the United States toward recovery might come about. But on either reckoning, it did not seem necessary to reach the conclusion that world trade was likely to slow down very much in 1970. In general, he therefore drew a more optimistic picture than Mr. Lieftinck's. In the past 25 years the world had advanced significantly in learning how to control the international economic environment, although one still could not talk of fine tuning. Nevertheless, the situation was far more precarious than anyone would like it to be, and there had never been a time when it had been more important to explore further ways of improving both the working of the adjustment process and the international monetary system. He believed progress was being made in those directions also.

Mr. Suzuki said that GNP growth in Japan during the last calendar year had been 14.4 per cent in real terms. Since then production and other indicators tended to be on the strong side. At present Japan was in a comfortable position both externally and domestically.

Mr. Suzuki noted that on page 13 of the staff paper it was stated: "In Germany and Japan, domestic and external targets seem less easy to reconcile." In his view, domestic and external targets in Japan were in fact not difficult to reconcile. He said that wage increases, which

were usually settled in the springtime, would show a 16 per cent rise over 1968, and consumer prices were expected to rise around 5 per cent. He noted from the draft of Supplementary Note B of the Annual Report that Japan's reserves had declined by about $100 million since the end of March. That was mainly due to the so-called "yen shift," which was due to financing of imports by yen instead of foreign currencies. That was caused in turn by the tightness of the Euro-dollar market; some of the foreign exchange banks, finding they could not renew Euro-dollar borrowing, financed Japanese imports by means of yen. The situation therefore was one of a strong current balance, and an unexpected surplus in the long-term balance, together with a large deficit in the monetary account, especially with regard to the foreign exchange position of the banks. He noted that Table B-7 of Supplementary Note B of the draft Annual Report showed a trade surplus of $2.5 billion in 1968. However, that account was on an f.o.b. basis. If the figures were transferred to an f.o.b./c.i.f. basis, then the account would be almost in equilibrium. He noted that in the Annual Report, the German trade account was put on an f.o.b./c.i.f. basis. If the two accounts were put on the same basis, then the Japanese trade surplus would not be as big as the German. The figures showed a capital outflow from Japan of $828 million in 1968. However, if one considered the gross outflow of domestic capital which accompanied certain Japanese exports, then the figure would be almost $1.3 billion. In addition, Japan was in chronic deficit as far as services and the invisible account were concerned. In 1968, the deficit was $2 billion, excluding some government special receipts. The Japanese target was therefore a sizable export surplus, in order to finance the invisible deficit and the outflow of domestic capital.

Mr. Suzuki said that the inflow of foreign capital into Japan in 1968 was somewhat unusual. Table B-7 of Supplementary Note B of the Annual Report showed that this item had been $730 million, while the figure for 1967 had been minus $33 million. The large surplus could be attributed to a large increase in the inflow of foreign capital, in the form of foreign loans by commercial banks, and some bond floating in Germany. In addition to that, foreigners had made heavy purchases of Japanese stocks. The figure for purchases of Japanese stocks by foreigners was between $60 million and $100 million a month. It was uncertain whether that situation would continue. The Japanese aim therefore would continue to be a surplus in order to finance the invisible account and a more vigorous extension of economic aid. Moreover, the present level, $3 billion, of Japan's foreign exchange reserves could not be considered high compared with the level of other industrial countries, especially when the large short-term indebtedness on the foreign exchange account was considered. If one looked at the balance sheets of foreign exchange banks, short-term indebtedness of almost $4 billion could be seen.

Mr. Suzuki said that Japan's export performance depended very much on the economic situation in the United States. As the staff had said, Japan's balance of payments was by nature volatile. The effect on Japan of a move toward surplus positions on the part of the United States and the United Kingdom could therefore be considerable. Moreover, Japan benefited from special government receipts of almost $600 million. Events in Viet-Nam could affect that item. The future outlook was therefore somewhat doubtful, and the feeling of the Japanese was not completely optimistic as far as the future balance of payments was concerned. Noting the sentence on page 13 of the staff paper, "Japan's current balance of payments is more volatile in nature, and its current account surplus appears to be less persistent than that of Germany," he said that if this meant that a current account surplus of the present magnitude was less persistent, then he would agree with the staff's view. However if it meant that a current account surplus of any kind was less persistent, then he would be inclined to disagree.

In conclusion, Mr. Suzuki agreed with Mr. Schleiminger that the final sentence on page 13 of the staff paper applied to all countries, and not simply Germany and Japan.

Mr. de Maulde expressed some doubt about the general purpose of the paper, which seemed to him to be an exercise in inconsistency. The main conclusion that one could draw from it was that the different forecasts made by various OECD countries on the future of their trade balances were completely inconsistent. It seemed that there were two possibilities. At one extreme the trade pattern of 1968 and 1969 would continue, bringing with it the difficulties which were well known. The creditors would remain creditors, and the debtors would continue to be debtors. Disruptive speculative movements would remain a threat to the entire system. The other possibility was that the forecasts of the debtor countries would by some miracle be realized. In that case, the non-OECD countries would be the victims. In addition, restrictive trade measures would most probably be implemented, and there would be a prospect of severe deflation. Neither course was therefore desirable. While one might draw some comfort from the historic fact that forecasts were never realized, a third course appeared necessary, namely, that described as Case II on page 16 of the staff paper. That case was an attempt to modify the forecasts in order to arrive at something which would be less drastic for everybody. The main question was therefore whether the ordinary tools of economic policy were sufficient to reach that kind of objective. Like Mr. Lieftinck and Mr. Johnstone, he thought that perhaps more imagination might be necessary, and that less conventional tools might have to be used.

Mr. de Maulde then commented on the first two sentences of the third paragraph on page 13 of the staff paper: "The United States, the United Kingdom, and Canada face little conflict between the objective of

achieving or maintaining (in the case of Canada) external equilibrium and that of restoring a reasonable degree of price stability. A similar generalization may also apply to France, although the situation there is complicated by the existence of some excess capacity." Being somewhat puzzled by this assessment, he had examined the figures in Table 3 of the staff paper, and reached the conclusion that unemployment in Canada was at present about 350,000, in the United Kingdom about 500,000, and in the United States about 2,700,000. By the same method of calculation one would arrive at a figure of slightly under 250,000 unemployed in France. It would therefore seem that there was somewhat more excess capacity in the first three countries than in France, and that it would be less difficult to impose a restrictive policy in France than in the other countries. He asked the staff for a further explanation.

Another staff representative from the Research Department said that it was notoriously difficult to compare the unemployment figures of various countries, because of problems of definition and measurement. The remark about some excess capacity in France was based on a comparison not with other countries, but with the level of unemployment in France in the earlier years of the 1960's, particularly 1964-1965, when the economy was growing at full capacity. The number of unemployed was still high in comparison with those years, despite the recent declines.

Mr. de Maulde doubted whether that method of assessing the excess capacity in France was completely correct, because of demographic factors. Between 1945 and 1963 the total number of employed persons in France had not grown, on account of the low birth rate between the two World Wars. During the 20 years immediately following World War II, therefore, the situation had been abnormal. Since 1964, the situation in the labor market had been more normal. He was not sure whether excess capacity existed at present in France; in fact his own assessment would be rather the contrary.

Mr. Stone said that the staff paper was concerned principally with the OECD countries, which constituted only a part of the world economy. He hoped that Executive Directors would have further opportunities of having informal discussions of the kind they were now engaged in, but at a time when they would be free to devote more time to preparing for the discussions. He also felt that the staff paper should have been available somewhat earlier.

Although he represented four primary producing countries, Mr. Stone did not share the fear of some Executive Directors about the implications of the OECD forecasts on which the staff paper was based. He thought that the forecasts might perhaps oonceal more than they revealed, and remarked that, in national politics, pressure groups which wished to influence the government made forecasts which, if taken at their face value, would naturally lead the government to adopt the policies which the pressure group sought. The explanation of his relative calm after

reading the staff paper lay in the heavy weight which he placed on the conditional clauses which began the more terrifying sentences of the paper. For example, the second sentence of the first full paragraph on page 12 began with the words "If the U.K. and the U.S. were to improve their trade accounts so as to achieve the 'targets'... ." Moreover, the first sentence of the second paragraph on page 13 contained the words "if the OECD projections for the United States and the United Kingdom were to be accepted... ." He laid heavy emphasis on the word "if," and wondered how many people really believed that the United States and the United Kingdom would be able to achieve the postulated outcomes on the basis of present policies. He saw little sign of it, even on the assumption that the U.S. House of Representatives would that day vote to extend the tax surcharge.

In conclusion, Mr. Stone agreed with Mr. Lieftinck that lasting rectification of the positions of the reserve currency countries was likely to be achieved only by a change in the relative competitive position of their exports vis-à-vis the major surplus countries. That objective would not be achieved by policies of temporary "stop," even if the aims of those policies were to be reached before the next period of "go."

The staff representative from the Research Department, replying to remarks by Directors, said that the staff had tried, in the document that had been the basis for discussion, to show prospective changes in aggregate demand, output, prices, and trade balances in the main industrial countries. For that purpose the only set of comprehensive, internally consistent data were the forecasts prepared by the OECD Secretariat. Such forecasts were by nature uncertain, and the staff's own assessments in some cases differed considerably from those of the Secretariat and those of national officials.

Turning to the part of the paper dealing with trade analysis, the staff representative from the Research Department remarked that the OECD projections of trade balances for 1969 and the first half of 1970 indicated little change in the balances of the two reserve currency countries, and continued large surpluses in Germany, Italy, and Japan. If these projections were in fact realized, there would be only limited progress toward what most observers would consider to be better equilibrium in the international payments situation. In view of this, the staff had thought it worth pointing out that the national forecasts of the United Kingdom and the United States differed markedly from the OECD forecasts inasmuch as the authorities of those two countries were anticipating a substantial improvement in their trade accounts.

Continuing, the staff representative from the Research Department noted that not only did the national forecasts for the United States and the United Kingdom differ from the OECD forecasts, but they were also inconsistent with the OECD projections for the other countries. In this

situation, the staff had thought that it would be useful to assess quantitatively the effects on the trade balances of other countries if the United States and the United Kingdom succeeded in achieving their targets. In these calculations, there was no assumption that the projections of the United States or of the United Kingdom, or of the OECD, were necessarily correct. It would be possible for the United Kingdom and the United States to meet their targets on the basis of present policies since the growth forecasts of the national authorities were similar to those of the OECD. For the period from the first half of 1969 to the first half of 1970, for example, all were agreed that very low growth was likely. Where they differed was in the response of the trade balance, and particularly of imports, to that growth. The OECD Secretariat foresaw that imports would remain high and continue to rise, whereas the national authorities thought that the slow growth would have an appreciable dampening effect on imports. If the United States and the United Kingdom reached their targets on the basis of present policies, the pattern of trade balances among the countries concerned would be as shown in Table 8 on page 11 of the staff paper, according to either Case I or Case II, or perhaps some combination thereof. The staff representative added that if the United Kingdom and the United States were to achieve their trade targets through a reduction in first-half 1970 imports as projected by the OECD Secretariat, the growth of OECD foreign trade from the first half of 1969 to the first half of 1970 would be roughly 2 per cent less than the 8 per cent increase forecast by the Secretariat.

The discussion paper, said the staff representative from the Research Department, had taken no position with respect to the forecasts and did not intend to be pessimistic. However, if one believed that the OECD forecasts would prove to be correct, then there clearly would be grounds for pessimism. Two main possibilities would be open. One would be to accept the very limited progress toward balance of payments adjustment in the year ahead. The other would be to correct the imbalances through stronger policies of demand restraint in the two reserve currency countries. If the United States and the United Kingdom believed that the OECD forecasts were correct and still wished to do something to achieve their targets, the question would be by how much they would have to cut back GNP in order to achieve the desired import response. As could be seen from Table 2 of Appendix I, the United States would need to reduce the growth of its imports over the period from 11 per cent to a little less than 7 per cent, while the United Kingdom would have to bring about an import change from the increase of 5.3 per cent forecast by the OECD to a decrease of 3.8 per cent. If reasonable elasticities between import growth and changes in GNP were applied, the conclusion would be that the economic impact of the necessary cutback in domestic growth rates would be fairly severe. The projected growth rates were already low, so that if additional restraint were applied real growth might well be reduced to zero or even become negative; and even this was on assumptions regarding the relationship of imports to GNP growth that the staff considered fairly optimistic. One

way out of this dilemma would be if the surplus countries allowed their growth rates to accelerate above those forecast by the OECD. An additional two or three percentage points in nominal GNP expansion in a number of European countries would certainly help the United States and the United Kingdom in the situation hypothesized. However, such additional expansion might well be considered by the European countries to be undesirable from the standpoint of their own domestic situations, which were becoming increasingly inflationary.

The main conclusion he had drawn from this exercise, said the staff representative from the Research Department, was that it must be hoped that the OECD Secretariat's forecasts were wrong. Indeed, a resonable case could be made for thinking that they were too pessimistic. For instance, no allowance had been made for any improvement in the U.S. trade balance from now through the second half of 1970, despite the marked slowdown in growth that was assumed. The OECD had assumed that the poor price performance of the United States for the past few years would begin to have an effect, that import buyers would not readily switch back to domestic sources, and that suppliers abroad would not easily abandon their markets in the United States. So far as the United Kingdom was concerned, the Secretariat believed that the labor market situation and the general pressure on resources were such that domestic demand, and particularly consumer demand, would be significantly higher than was assumed by the authorities and that the shift of resources to the external sector would be correspondingly less. In particular, the OECD Secretariat did not seem to have assumed very strong effects on the U.K. balance of payments of the recent tightening of monetary policy.

In conclusion, the staff representative from the Research Department said he wished to emphasize that the purpose of the paper had been to show the relationships among the trade balances of the countries concerned. The figures certainly did indicate that, in view of the constraints imposed by the existing geographic distribution of trade, the United States and the United Kingdom might have difficulty in substantially improving their trade balances, but the situation would call for real pessimism only if one assumed that the OECD forecasts were correct. The Secretariat itself had been frank in terming the forecasts highly uncertain; it had said, for instance, that all the U.S. authorities could do was to continue their anti-inflationary policies and await results, since the range of possibilities for the outcome of the U.S. trade balance for the first and second halves of 1970 could be very wide indeed.

W. LAWRENCE HEBBARD
Secretary