Book Review of Europe and the Dollar

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BOOK REVIEW

EUROPE AND THE DOLLAR: By CHARLES P. KINDLEBERGER.[1] Cambridge, Massachusetts: The M.I.T. Press, 1968. Pp. 297. $3.95.

The complex, nebulous, esoteric subject of the international monetary system is appearing ever more frequently in the headlines of our daily newspapers. Discussions of the price of gold, the balance of payments, and the relative strengths of the dollar, pound, mark and franc are no longer relegated to the board rooms of New York banks and American corporate giants or to the offices of the Treasury Department and the Federal Reserve System in Washington. Even the man-in-the-street will offer you his views on these difficult problems. The story circulating among economists, which is told not entirely in jest, is that there are two men in the world who fully understand the structure and operations of the international monetary system. They are both wizened, old, grey-headed men who wear 40 Years of Faithful Service pins and the green visor of the lowly clerk. One sits in the subbasement of the Treasury in Washington; the other sits in a cold, damp, dark office of the Exchequer in London. They know the system. The problem is that they disagree.

Three times since November 1967, the world has been treated to the spectre of a major crisis threatening its monetary system. And three times, officials of the world's major monetary powers have managed to agree upon a set of measures to preserve the system. The first crisis, in November 1967, involved speculation against the British pound and culminated in the devaluation of that currency. The second crisis followed in the spring of 1968 and threatened the value of all the world's major currencies as speculators and citizenry alike moved out of paper money and into gold. That crisis was resolved by a decision to isolate transactions in official monetary gold from those in privately held nonmonetary gold. The third crisis was precipitated by a massive flight out of the French franc into other currencies, primarily the German mark, in November 1968. This also threatened the perennially weak pound. Belt-tightening measures by France and the United Kingdom and import tax and export rebate adjustments by Germany were put into effect to end this crisis.

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Professor Kindleberger's book provides background information of varied analytical depth which is of value in attempting to understand the international monetary system and the long-term origins of the most recent crises. In this volume, he has gathered together 17 papers and memoranda which he wrote in the period 1939-1965 dealing with international monetary relations among the developed countries. The book is not intended to be a complete treatise on the subject. Professor Kindleberger states in the preface that he collected these papers for publication since they had not previously appeared in routine scholarly channels and would otherwise probably have been lost to the public.[2] The chapters are arranged chronologically, by date of writing, rather than by subject matter. This arrangement is interesting for the insight it gives into this eminent economist's changing analytical response to the rapidly moving economic developments of this 26-year period. However, it does present problems to the reader whose knowledge of international economics is limited. In fact, the reader whose knowledge is limited might best be advised not to attempt most of the papers presented in the book until he has developed a basic acquaintance with the discipline.

Since the end of World War II, one of the most interesting developments on the world monetary scene has been the shift in the position and relative strength of the dollar, to which Professor Kindleberger devotes several chapters. In the immediate postwar period there was a great shortage of dollars in the world as the war-ravaged countries turned to the U.S. to supply their consumption and investment needs. With an intact productive capacity and unprecedented gold reserves standing behind the dollar, it assumed the primary position among the world's currencies. Dollars were actively sought by foreigners both to pay for imports from the U.S. and to add to the reserves backing up their own national currencies. From 1950 onward, with occasional interruptions, the U.S. ran a balance of payments deficit. This very deficit is what allowed the Europeans to add to their holdings of dollars. Suddenly, in 1958 and 1959, the average annual U.S. deficit more than doubled from the averages of the 1950 to 1956 period.[3] In 1958, the U.S. began losing gold as foreigners for the first time since the war turned in dollar holdings to make net purchases of gold. They thereby indicated they would no longer hold unlimited amounts of

2. C. KINDLEBERGER, EUROPE AND THE DOLLAR, vii (1966).

3. *Id.* at 138.

dollars. This marked the end of the dollar shortage and the beginning of the dollar glut, as it is called. U. S. officialdom was forced to turn its attention to the causes of the persistent balance of payments deficit and to seek measures to restore equilibrium.

In a paper written early in 1960, Professor Kindleberger turned his attention to causes of and cures for the disequilibrium.[4] There was a tendency in this period to blame the balance of payments deficit on inflationary disequilibrium. It was thought that inflation in the U.S. was pricing U.S. goods out of their competitive position in the world market. Professor Kindleberger marshals impressive evidence against this conclusion, although he does admit that the evidence does not absolutely disprove the allegation.[5] He focuses rather upon a structural disequilibrium as the more important cause of the U.S. deficit and cites five structural changes since 1953 to which the U.S. balance of payments had not adjusted by 1960[6] and to which, in fact, it has probably not yet adequately adjusted itself. The first two are an increasing supply of U.S. imports and of competing exports in other markets, both of which resulted from the success of U.S. policies in aiding the reconstruction of Western Europe and Japan and from "a rapid closing of the technological gap which previously separated these countries from the U.S." Many would argue that the technological gap has once again become a yawning chasm in the course of the 1960's, even though it was closing in the 1950's. However, the U.S. continues to be faced with increasing competition in its own domestic and in other markets from the efficient industrial plant which it helped create in Western Europe and Japan after the war. The other three structural changes involve what Professor Kindleberger has appropriately called "this country lifting the horizon of its economic vision more completely to the world level." These three changes are as follows: (1) "an increased demand in the U.S. for imports from Western Europe and Japan, especially of consumers' goods which are differentiated from U.S. products;" (2) "an increased awareness of and interest in the possibilities of producing goods abroad at costs below those in the U.S., with a resulting expansion of direct investment" by the U.S. abroad; and, (3) "increased awareness of and interest in foreign securities." These factors may still be looked upon as contributing very basically to the U.S. balance of payments deficit.

4. *Id.*, Chapter Nine.
5. *Id.* at 138-44.
6. *Id.* at 145-46.

In the most recent essay included in the book, written in 1965, Professor Kindleberger retains his belief in the basic soundness of the U.S. dollar. He was not, even at that late date, overly concerned about measures to cure the disequilibrium and probably feared more than anything else, as he expressed it in earlier essays, that the U.S. would take measures to restrict either trade or capital flows, which might be a cure worse than the disease. In Chapter One, Professor Kindleberger argues for a more appropriate definition of a balance of payments equilibrium. Non-economists should be made to realize the subjective and arbitrary nature of the equilibrium definitions used by economists in discussing the balance of payments. As Professor Kindleberger says, ". . . it is important that subjective appraisals discard the terrifying definitions we have allowed to creep into the discussion, and recognize the fact. Objective circumstances of strength can be turned into chaos by subjective judgments." [7] The problem here is analogous to the two little old men who know the international monetary system, but disagree. The objective strength of the dollar defined by one economist is seen by another as a mere subjective judgment. But one thing is certain. In an international monetary system which relies so heavily for its existence upon continued worldwide confidence in the stability and strength of the dollar, it is the subjective judgments of the traders, investors, and speculators which can make or break the system. Therefore, it is of little help to the dollar if the U.S. official definition of balance of payments equilibrium overstates the weakness or understates the strength of the dollar and thereby falsely molds the subjective judgment of dollar-holders around the world.

In this collection, Professor Kindleberger devotes equal time to the events in the recent economic history of Europe and to the characteristics of the European economy which have affected international monetary relations. In a paper written in 1963, he discusses an interesting phenomenon related to the European capital market which occurred in the 1950's and early 1960's.[8] Because of the general underdevelopment of the European capital market and the lack of financial integration in Western Europe, it became commonplace for Europeans to float their bond issues in the New York market and also for European investors to purchase a large portion of these bond issues. It was his thesis at that time that no single financial center for long-term capital

7. *Id.* at 24.

8. *Id.*, Chapter Five.

would develop on the Continent, but that the well-developed, broad New York market would serve this function for Europe. If it hadn't been for the U.S. Interest Equalization Tax and for the more recent voluntary and then mandatory controls on outflows of investment capital from the U.S., this development would probably have continued. While European national capital markets remain relatively underdeveloped today, European corporations and American corporations operating in Europe are resorting ever more frequently to the Euro-dollar market and to floating bond issues denominated in dollars to fulfill their long-term capital requirements. So European financial integration may occur after all by means of the U. S. dollar.

In another very interesting chapter, Professor Kindleberger turns his attention to the role of international corporations in European economic integration.[9] It is his thesis that economic integration cannot be achieved merely by eliminating barriers to the flow of goods and services across national boundaries. Economic integration also implies the free movement of factors of production across boundaries. The Rome Treaty, which established the European Economic Community in 1958, provides for such free movement. While labor has moved rather freely between some regions of the Community, this has been much less the case with capital. Professor Kindleberger argues that organized markets for goods, services, labor, and capital may not prove adequate to achieve complete integration, and he cites the role of the national corporation in the economic integration of the U.S. Such a corporation borrowed money where it was cheapest, probably in New York, and invested that money where it could put labor and materials together in least-cost combinations, relative to market outlets.[10] This tended to cause equalization of factor prices and thus integration of the American economy. The American corporation has seen fit to enter the European Community, establish operations where this least-cost combination is attainable, and reap the benefits of a large, affluent market with reduced, and now eliminated, barriers to trade within that market. And all this has been done with little or no regard to national political boundaries. On the other hand, European corporations have tended to retain their narrowly nationalist outlook and continue to produce only in their home countries. The absence of a unified body of European corporate law has impeded the establishment of interna-

9. *Id.*, Chapter Two.
10. *Id.* at 29.

tional operations by European corporations. However, once such a body of law is established, the mind of the European business executive will have to be shaken loose from its traditional, conservative patterns of thought before the European corporation may play its rightful role in the integration process.

As stated at the outset of this review, Professor Kindleberger's book provides valuable information on the international monetary system and on the long-term origins of the recent crises. However, because of the form in which it is presented, that is, a collection of papers and memoranda, and because of the considerable analytical depth characterizing most of the essays, the audience appeal of the book is rather limited to those with a vocation, or at least a serious avocation, in economics. Europe and the Dollar is definitely not "Everyman's Guide" to international financial relations among developed countries.

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