

PROPOSALS FOR A NEW BRETTON WOODS CONFERENCE AND A NEW REDEFINITION OF THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK

(THEORY OF THE COMPARATIVE ADVANTAGES OF RICARDO AND MILL COMPLETED)

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I Introduction

David Ricardo's theory of comparative advantage was later complemented by John Stuart Mill. Ricardo and Mill's comparative advantage theory is the strongest argument to justify trade between two countries. However, the application of the theory as a theoretical instrument to guide the work of international trade in the countries is poor. This is because the theory of comparative advantage explains how a country benefits from its international trade with another country and under what conditions it can optimize the benefit, but does not explain under what conditions a country can optimize the benefit of its trade with more than one country, that is to say with multiple countries, which is the practical reality faced by all countries. In addition, the theory of comparative advantages, while analyzing why an A country should keep its trade balance in equilibrium with another B country (Mill's contribution) as a way to optimize the benefit of international trade between the two countries, does not analyze the role played by the rest of the balances in the balance of payments between the two countries on the benefit that can be obtained from international trade. Nor does it analyze the role that plays the equilibrium in all balances within the balance of payments with multiple countries on the benefit that can be obtained from international trade.

Consequently, the theory of comparative advantage is an incomplete theory.

In this paper, we intend to complement the theory of Ricardo and Mill's comparative advantages over international trade in order to explain under what conditions a country optimizes the benefits of its international trade by balancing its trade balance with multiple countries. In addition, will be analyzed the effect of balances and imbalances on the financial balance, the capital balance and the current account balance on the benefit that a country can gain from its international trade with another country and with multiple countries.

This complementation of the model of comparative advantages will make it possible to outline the criteria under which institutions seeking to regulate international trade between countries such as the International Monetary Fund and the World Bank should be established and organized.

That is to say, of the complementation of the Ricardo and Mill model must give rise to the reasons why the International Monetary Fund and the World Bank should have a redefinition of their goals and objectives or be replaced by new institutions with new goals and objectives. As a result, this complementation should give rise to the reasons why a second Bretton Woods conference should be convened to establish a new agreement on international trade.

II Theory of the Comparative Advantages of Ricardo and Mill

We will begin by discussing the model of Ricardo and Mill with respect to the benefits that can have two countries of their trade with each other.

The optimal benefit of two countries of international trade between them is achieved when they reach the maximum possible joint productivity corresponding to the point where exports are equal to imports. That increase in joint productivity is what both countries will have to obtain as a result of trade between them. The maximum joint productivity between two countries is reached when both countries have specialized in the production of those goods where they have comparative advantages, that is, where they are relatively more productive.

Country A has an absolute advantage in the production of a good with respect to another country B when it employs fewer factors of production, that is, less units of living labor (employment) and dead (capital depreciation) in the production of that good (greater productivity) than country B.

Country A has a comparative advantage in the production of one good with respect to another country B when, given the exchange rate between the currencies of both countries, it can sell that good in country B at a price lower than the price of that good produced in country B.

When two countries A and B trade with each other, they can generate an increase in productivity and, consequently, in total production, as a result of the fact that both countries specialize in the production of those goods where they have comparative advantages. The goods in which country A will have comparative advantages over country B will be those that it can produce and sell in country B at prices lower than the prices of the same goods produced in country B. The price of goods from country A in country B will depend on two factors: 1. The relative productivity of country A in the production of each good and 2. The exchange rate between the two countries. These two factors determine the price of the goods of country A in the other country B with which it is traded.

Let's look at an example. Suppose that country A, as compared to country B, has absolute advantages in the production of all goods, that is, A is more productive in the production of all goods than B. It does not matter the greater the absolute productivity of the country A in all goods on the productivity of country B, the price of all goods of country A expressed in the

currency of country B will depend on the exchange rate. The more monetary units of country B are to be given by a monetary unit of country A, the higher the prices of country A goods expressed in the currency of country B and, consequently, the more expensive will be the goods of country A in Country B, no matter how high is the productivity of country A over country B in relation to the production of all goods.

Assume an extreme exchange rate in which all goods in country A have higher prices in country B than the same goods produced in country B. In that case, since goods produced in country B would have lower prices than those coming from country A, because of the extreme exchange rate, then consumers in country B would have no incentive to buy goods from country A, no matter how much higher the productivity of country A than country B could be in the production of all goods. However, if the exchange rate is gradually reduced, that is to say, we are paying less and less monetary units of B for a monetary unit of A, it is necessary to arrive at the time when some goods of country A begin to have lower prices in country B than the price of that good produced in country B. In that case, consumers in country B would be better off buying those goods in country A. Which would be those goods in country A that would start to have lower prices in country B currency due to the gradual reduction of the exchange rate? The answer is, those in which country A is relatively more productive. That is to say, those in which the absolute advantages of country A are proportionally greater than the absolute advantages of the other goods in which it also has absolute advantage. What would be the other goods of country A that would continue to have higher prices in country B currency after the above-mentioned gradual reduction of the exchange rate? The answer is, those in which country A is proportionately less productive. That is, those in which the absolute advantages of country A are proportionally less than the absolute advantage of the other goods in which it also has an absolute advantage. Consequently, we can expect that country B will import from the country A those goods where the prices of A are lower in the currency of country B than the prices of those goods in country B. and buy locally the rest of the goods.

If the rate of exchange is gradually continues to be reduced (appreciating the currency of country B), the opposite extreme moment has to come when all the goods of country A are cheaper in country B than goods produced in country B. Consequently, it would be convenient for the consumer in country B to purchase them from country A instead of buying them locally. But this would be an extreme situation that could not happen, since before country B could reach that extreme of producing nothing, its economy would collapse.

Between one end and the other of these exchange rates, there must be one in which the value of the goods purchased by country B from country A is equal to those bought by country A in country B. At that point exports of each country will be equal to their imports and that is the equilibrium exchange rate by definition.

We say that this is the exchange rate of equilibrium in the foreign exchange market between the two countries because any other exchange rate that will arise will tend towards this one and also because that which tends to prevail once established. For example, if the currency of country A were appreciated by increasing the exchange rate, then it would increase its imports

above its exports. The deficit in the trade balance of country A increases the money of country A in the hands of country B and creates pressure for the exchange rate to be reduced. The reduction in the exchange rate will increase exports and reduce imports from country A. The pressure will continue and the exchange rate will continue to decline until exports equalize imports and the deficit disappears. The same reasoning applies in the opposite direction.

But the beauty or strength of Ricardo and Mill's theory of comparative advantages lies in the fact that the equilibrium solution described above takes into account, not only the productivities in the two countries, but the size of the population in the two countries, as well as the distribution of income in the two countries and the tastes and preferences of the consumers in the two countries. The equilibrium solution takes into account all the above factors because they will be reflected in their corresponding demands for imports and offers of exports of the different goods. Consequently, this equilibrium solution determines not only the goods and services in which each country must specialize, but also determines the terms of trade. That is, given the productivities of each country, the equilibrium exchange rate determines what each country will have to obtain in order to benefit from the increase achieved in the joint production of the two countries. What each country will gain depends on its productivity, its supply of goods, its demand for goods and, consequently, its contribution to the volume or level of that trade or joint production between the two countries.

In conclusion, the exchange rate that balances exports with imports of goods from both countries is the equilibrium exchange rate and is the one that determines the prices of goods in each country and, therefore, determines the goods in which each country must specialize and simultaneously determine what each country will get from the benefit of the increase in joint production.

III Most Relevant Neoclassical Theories on International Trade

Theory of Paul Krugman

Paul Krugman's new theory of international trade does not contradict either the conclusion of Mill's theory of comparative advantages over the exchange rate that balances exports with imports, nor the conclusion of Ricardo's comparative advantage theory about the existence of comparative advantages and the benefits that countries obtain from international trade.

Paul Krugman states that international trade patterns do not correspond to the hypothesis that countries trade and specialize in the production of those goods where they have comparative advantages. On the contrary, they seem to trade similar goods. The explanation for this to happen is found by Krugman in that economies at scale can make a small country reach levels of productivity similar to those of other larger countries, through the expansion of its international trade. In such a case, the trade would not be determined by the comparative advantages, but by the preferences of consumers towards similar products but differentiated by their brands.

This approach of Krugman does not contradict the existence of an equilibrium exchange rate that equates exports with imports, nor the existence of comparative advantages.

Let's see. Suppose country A has the same labor productivity as country B in the production of all goods and suppose that the goods are homogeneous. In such a case, there will be no absolute advantages and comparative advantages in the production of some good and the prices of the goods would be equal in both countries. That is, when the exchange rate in the foreign exchange market is that of equilibrium, the exports of both countries will be zero and equal to their imports. That is, when the exchange rate in the foreign exchange market is that of equilibrium, the exports of both countries will be zero and equal to their imports because the prices of the goods of country A in country B would be equal to those of country B and vice versa. Consequently, there would be no reason to buy foreign goods. Any exchange rate other than equilibrium and that appreciate the currency of country A will make all goods in country A more expensive in country B than goods in country B and vice versa. Consequently, trade deficits or surpluses are expected to lead to the equilibrium exchange rate, which, as we have pointed out, is where import prices in both countries would be equal to local prices and, therefore, there would be no trade. According to the theory of comparative advantages of Ricardo and Mill, since products are assumed to be homogeneous, there would be no reason for international trade to occur.

Let us now remove the homogeneous assumption from the theory of comparative advantage and substitute it for the assumption of Krugman's theory of similar but differentiable goods. In such a case, if we maintain the assumption of equal productivity in the two countries, international trade would take place on the basis of consumer preference over different brands of like products.

If the preferences of the consumers of country A for the goods of country B were the same as the preferences of the consumers of country B for the goods of country A, then imports of A would be equal to their exports and there would be equilibrium.

If, on the contrary, the preferences of the consumers of country A for the goods of country B were greater than that of the consumers of country B for the goods of country A, then imports of A would be greater than their exports and would generate a deficit in its trade balance. The accumulation of foreign exchange from country A in country B would lead to the depreciation of country A currency until the equilibrium exchange rate was reached. That is, the depreciation of the country A currency would cause the prices of all similar but differentiated goods in country B to become increasingly expensive in country A, decreasing imports until an equilibrium exchange rate which equates exports with imports be reached.

As can be seen, the introduction of the assumption of similar but differentiated goods, as well as the introduction of the assumption of economies of scale that equate labor productivity across countries, does not contradict the conclusion of Mill's theory of comparative advantages on the exchange rate that balances exports with imports

However, the assumption that two countries have all their goods similar but differentiated is as unrealistic as the alleged assumption that they have all their goods homogeneous. The most realistic is that some are similar but differentiated and others are homogeneous. In such a case, if the consumer preferences of country A for the goods of country B that are similar but differentiated were greater than those of country B for the same types of goods in country A, then, as we have said, imports of A of this type of goods would be greater than their exports and would generate deficits in their trade balance that would lead to the depreciation of the currency of country A. On this occasion, the depreciation of A currency would make some of its homogeneous goods, as well as some of its similar but differentiated goods, were now cheaper in country B than those of country B and would increase their exports of homogeneous and similar but differentiated goods to country B. Consequently, the process would continue until the balance between imports and exports was reached.

This result also does not contradict the conclusion of Mill's theory of comparative advantages in terms of the equilibrium exchange rate.

However, the assumption that country A has equal labor productivity as country B in the production of all goods is as unrealistic as the assumed opposite of having different productivities in all goods. The most correct thing is that it has equal productivities in the production of some goods and unequal in the production of others. In that case, there would be comparative advantages, and countries could benefit from their international trade if they specialize in the production of goods in which they have comparative advantages. That is what would happen if the equilibrium exchange rate were set.

As can be seen, the introduction of Krugman's assumption about economies of scale that can match the labor productivity of some goods of a large A country with the labor productivity of same goods in a small B country, does not contradict either the conclusion of Ricardo's comparative advantage theory on the benefits each country derives from international trade.

As can be seen, Krugman's theory complements the theory of comparative advantage and does not contradict it.

Theory of Heckscher-Ohlin

Heckscher-Ohlin's theory states that comparative advantages are a product of differences in the abundance of factors of production between countries, while Ricardo says that it is due to the difference in labor productivity. Heckscher-Ohlin state that the more abundant a factor, the lower its cost and, consequently, the countries export the goods where the most abundant factors are used more intensively. The empirical evidence contradicts Heckscher-Ohlin's theory and, on the contrary, confirms Ricardo's theory. That is, the United States, where capital and technology abound, are exporting labor-intensive goods to countries where cheap labor is abundant, such as food, which contradicts Heckscher-Ohlin. The explanation for this behavior

of the United States in international trade is because the productivity of agricultural labor in the United States is greater than that of other countries with more abundant labor. Consequently, it has an absolute advantage in the production of agricultural goods, as well as in the production of industrial goods. However, if the absolute advantage (higher labor productivity) in the production of agricultural goods is proportionally greater than the absolute advantage in the production of industrial goods, then it will have a comparative advantage in the production of agricultural goods and comparative disadvantage in the production of Industrial goods, no matter that it has an absolute advantage in the production of both types of goods. It is relatively more productive in the production of agricultural goods than in the production of industrial goods probably due to the high mechanization and technology used in agriculture in the United States.

Consequently, what determines the value of a good of country A in country B is the number of units of living labor (employment) and dead labor (depreciation of capital) that is used to produce a unit of good in country A vs. which is used in country B. For example, if 3 units of live and dead labor are used to produce a food unit in country A and 2 to produce the same amount of food in country B, then the productivity of country B would be $3/2 = 1.5$ times higher than the productivity of country A. And this is so, no matter what the abundance of the labor factor in country A or B could be. That is, if in country B, with a population, say ten times greater than that of country A, two units of living and dead labor are used to produce one unit of food, then country B has a labor productivity greater than that of country A. But if Country B employs 4 living and dead labor units to produce a food unit, then labor productivity in country B would be $3/4 = 0.75$ times lower than country A, no matter how abundant the labor factor in that country B could be.

That is what Heckscher-Ohlin's theory does not visualize. It is not the relative abundance of the factors of production that determines the price of goods of one country in another, but the relative productivity of labor and the rate of change. The wage of a country A, however low, does not determine the price of goods in another country B, as this is determined by the rate of change and the relative productivity of labor. Wages only determine the distribution of income within each country, but not the prices of goods abroad.

In conclusion, as we pointed out at the outset, the theory of comparative advantages of Ricardo and Mill, is the most solid foundation today to explain why international trade occurs. Krugman's theory of international trade complements the theory of comparative advantage by making it more complete and more solid.

IV The Application of the Theory of Comparative Advantages of Ricardo and Mill

The above explained in relation to the trade between two countries is what constitutes the theory of comparative advantages. However, to the extent that this theory is incomplete because it does not consider trade between multiple countries nor the equilibrium in the rest of

balances within the balance of payments, in practice the countries have made generalizations about this theory that do not follow from this theory.

In practice, some countries maintain or compensate the deficits in the trade balance with some countries, with the surpluses in the trade balance with other countries. This is the generalization that comes from the proposal of John Maynard Keynes representing the United Kingdom at the Bretton Woods conference.

Also in practice, countries maintain or compensate for deficits in the trade balance with all countries, with surpluses in the financial and capital balances with all countries. That is the generalization that comes from the proposal of Harry Dexter White representing the United States at the Bretton Woods conference and implemented by the International Monetary Fund and the World Bank. This practice has prevailed to this day.

Both positions or generalizations are wrong and in the next section we will explain why.

V The Theory of Comparative Advantages of Ricardo and Mill Completed

What is missing from the theory of Ricardo and Mill previously explained? It is missing from answer the following two questions:

1. Why should the exchange rate that balances exports with imports between two countries A and B should be the optimum and, consequently, the only criterion that should be applied when regulating international trade?
2. How will a country's benefits be affected when, apart from trade in goods and services, countries trade in capital (loans and/or investments)? In other words, what are the benefits that a country obtains when, apart from the trade balance, we must consider the analysis of the other balances in the balance of payments?

Why the Exchange Rate that Balances Exports With Imports Between two Countries A and B Should be Optimal?

The reason is simple. Any other exchange rate will generate long-term economic instability for both countries as it generates foreign debt. That is, the exchange rate that balances the trade balance has the peculiarity that it is the only one that guarantees economic stability between both countries A and B in the long term because it does not generate debt. Consequently, the equilibrium exchange rate is that which makes possible an exchange of goods between two countries, that can be sustained indefinitely over time. Any other exchange rate in which exports are not equal to imports would increase the external debt of one of the two countries, which is unsustainable in the long run and leads to recession in both countries.

When a country A balances its trade balance with all other countries B, C, etc. together, instead of by individual with each country B, C, etc. will be countering the surpluses contracted with some of those countries with the deficits contracted with the other countries. Consequently, it will be accumulating debt with some countries that it will not be able to sustain indefinitely in the long term. In addition, it will also be accumulating surpluses with other countries that cannot be held indefinitely in the long term, because by collapsing the economies of the countries with which it accumulates surpluses in the trade balance, it would produce recession in those economies as well as in their own.

The circumstance described above is the one that emerges from both Keynes's proposal and Dexter White's proposal in Bretton Woods. Under the circumstance described above, there is no exchange rate of equilibrium and the exchange rates of country A with other countries B, C, etc. are irrelevant when determining balance in the trade balance. What is implicitly proposing Keynes is that country A must generate the set of exchange rates with the other countries B, C, etc. that balance the country's trade balance with all other countries B, C, etc. as a whole. This stance is contrary and ignores the conclusions of the theory of the comparative advantages of Ricardo and Mill on the exchange rate of equilibrium between two countries. This solution, which is the result of Keynes's proposal at the Bretton Woods conference, is a mistake, because it will not prevent economic instability in the long run. The solution posed by Dexter White in Bretton Woods, proposes to maintain the equilibrium of the balance of payments in the country A with all other countries B, C, etc. as a whole. That is to say, the imbalance in the trade balance can be maintained, as long as the equilibrium of the balance of payments is maintained. This solution is also an error, because it will neither prevent economic instability in the long run.

Why is economic stability in the long run such an important factor in determining the exchange rate? What prompted the first and second world war was the struggle of the economic powers to secure the international markets as a means of maintaining the expansion of their exports. In this way the countries tried to ensure their growth and economic development, expanding their aggregate demand through exports. In addition, in this way, they tried to avoid recessions and economic instability in their country. But international trade is a zero-sum game, where some countries can not win at the expense of expanding their demands on the other because in the end, by causing the collapse of the country that imports their products, they end up provoking recession and economic instability in their own country.

The Bretton Woods conference is convened with the purpose of regulating international trade to avoid that what caused the first and second world war could be repeated. That is to say, it is convened to prevent the instability and economic recessions provoked by international trade could recur and bring a third world war. However, paradoxical as it may seem, the Bretton Woods agreement allows imbalances between exports and imports between two countries that are the source of instability and long-term economic recessions.

If Bretton Woods's purpose was to avoid the instability and economic recessions that produce wars between countries, then the benefits that countries derive from their international trade

developing must be restrained by that which must not affect economic stability. Consequently, the equilibrium exchange rate between two countries must have as its characteristic the one that allows economic stability in the long term. The exchange rate between two countries that allows economic stability in the long run is the one that equates exports with imports. It can not be any other. Any other generates economic instability in the long term and, consequently, recessions and war.

Paradoxical as it may seem, and despite Keynes' efforts to avoid it, as evidenced in his proposal, the agreement that was established at Bretton Woods, which was the proposal of Dexter White, allowed the country's trade balances to remain in imbalances and that some countries could export more than they imported by offsetting imbalances in the trade balance with imbalances in other balances within the balance of payments. Paradoxical as it may seem, this was agreed upon through the creation of the International Monetary Fund and the World Bank.

In conclusion, the exchange rate that balances exports with imports between two countries A and B must be the optimal.

1. Consequently, any A country that aspires to obtain the optimal benefit of its international trade with another B country, must maintain a rate of exchange that matches its exports with its imports.
2. Consequently, the exchange rate that balances the trade balance between two countries A and B, is the equilibrium exchange rate. That is, the exchange rate that balances the current account balance is not the equilibrium exchange rate, nor is it the one that balances all the balances within the balance of payments. Only the exchange rate that balances the trade balance is that of equilibrium.

Note that, in the context of what was discussed in the previous paragraphs, a country may have its trade balance in deficit and its current account balance in equilibrium, provided it has a surplus in its balance of income within its current account balance that is equal to the deficit in its balance of trade. Consequently, the exchange rate that balances the current account balance is not the equilibrium exchange.

What is true between country A and country B should be between country A and any country C, D, etc. Therefore, if country A wishes to obtain the optimal benefit of its international trade with all countries, it must maintain a rate of exchange with each of the other countries B, C, D, etc. that be of equilibrium and therefore equal their exports with their imports from each country per individual.

3. Consequently, country A obtains the optimum benefit of its international trade with multiple countries B, C, etc. when it establishes equilibrium exchange rates with each country B, C, etc. which equate their exports to each country B, C, etc., with imports from each country B, C, etc.

The proof of the above is derived from the following:

A country A that wishes to obtain the optimal benefit of its trade with another country B, should set the equilibrium exchange rate that equals exports with imports. This equilibrium exchange rate will reflect the relative productivity of each country, the size of its populations, the distribution of income of both countries and the tastes and preferences of the consumers of both countries, which will be manifested in their demands between both countries and will determine the size of their trade and the benefit to each country of the increase in joint productivity, that is, what is known as the terms of trade. If country A begins to have another trade relationship with a third country C and sets the equilibrium exchange rate between country A and C so that it equalizes exports with imports between countries A and C then the exchange rate of equilibrium from country A to country B will also change to reflect the change in country A demand for country B. That is, country A demand for foreign goods will be divided between two countries B and C instead of only one. Consequently, the demand of country A for goods of country B will be reduced and that will change the equilibrium exchange rate between the two countries in proportion to the changes in their demands. If country B subsequently established trade relations with country C, then the equilibrium exchange rate of country B with country A would again be modified and the equilibrium exchange rate of country C with country A would also be modified again to reflect the changes in the demand of each country with the other countries.

In conclusion, the optimal benefit of the international trade of country A with countries B and C is reached when country A sets its equilibrium exchange rates with countries B and C, so as to equalize exports with imports of each country by individual.

What is true for three countries will be true for more than three countries. Consequently, country A will achieve the optimum benefit of its international trade with multiple countries B, C, etc., when it equalizes its exports to each country B, C, etc., with its imports from each country B, C, etc. This is achieved by fixing the equilibrium exchange rate of its currency with each currency of the other countries. That is, it must keep the trade balance in equilibrium with each country by individual and not with all other countries collectively.

In conclusion, we can expect the exchange rate between two countries A and B to be periodically changing as other countries are added to trade of country A or country B and as trade relations of countries A and B change with the rest of the other countries with which they trade.

The foregoing finding contradicts the IMF's and the United States' policy of keeping fixed exchange rates tied to the dollar. This policy prevents or hinders that, to the extent that country A develops its foreign trade and initiates trade relations with new countries B, C, etc., it can keep adjusting its rate of change with each country per individual. In other words, in order to respond to the changes that arise in the demand for imports from country A with respect to country B each time country A initiates a new trade relationship with other countries C, D, etc., it is necessary that country A to modify its exchange rate with country B to take into account

the reduction of its imports with country B, which will now include imports of those same goods from countries C, D, etc. The same reasoning applies to all other countries C, D, etc. with which it trades country A. This is a very dynamic reality that is constantly changing in the short, medium and long term. Consequently, exchange rates have to be changing in order to maintain the balance in the trade balance of one country with the rest of the other countries per individual.

Consequently, the IMF's policy of maintaining fixed exchange rates tied to the dollar promotes the growth of countries' deficits and surpluses as the countries' international trade develops with the rest of the other countries. Consequently, this policy is completely contrary to the purpose for which the Bretton Woods conference was convened and the purpose for which the IMF and the World Bank were founded.

How Are Affected The Benefits Obtaining by a Country from Its Trade With Another When, Apart from Trade in Goods and Services, Trade Capitals?

The exchange rate that balances exports with imports between two countries A and B, is the equilibrium exchange rate. When currencies float in the foreign exchange market, the interaction between the supply and demand of currencies will generate the exchange rate that equates exports with imports between A and B, only when the other balances in the balance of payments are in equilibrium per individual also, so that it does not affect the determination of the equilibrium exchange rate in the trade balance. However, if the other balances in the balance of payments of countries A and B are not in equilibrium per individual, they will cause changes in the exchange rate to move the exchange rate away from equilibrium, which, as we have said, is defined as that which equals exports and imports from both countries. Note that it is said that the financial and capital balance should be in equilibrium by individual rather than jointly. Otherwise, they will produce an imbalance in the balance of income within the current account balance that would affect the determination of the exchange rate. The reason why this has to be so is because it is expected that the yield of interest on a level of loans in the financial balance will be lower than the return on profits of the same level of investments in the capital balance. Therefore, equal capitals, but with opposite sign on the financial and capital balances, will have to produce different levels of performance that are to be reflected in the balance of income within the current account balance. As a result, a deficit in the financial balance that is canceled with a surplus in the capital balance, generates different yields that will not cancel each other in the balance of income within the current account balance and that, therefore, will affect the determination of the rate of change of equilibrium in a regime of floating exchange rates. The same applies for the equilibrium exchange rate in the trade balance of country A with all other countries, apart from country B.

4. Consequently, any country A that aspires to obtain the optimal economic benefit of its international trade with another country B, by maintaining in equilibrium its trade balance under a floating exchange rate regime, should aim to maintain the equilibrium of all balances within the balance of payments with the other country by individual and

this includes the income balance within the current account balance. That is, to maintain at zero, the financial balance, the capital balance and the balance of income within the current account balance per individual. Otherwise, the floating exchange rate regime would not serve to achieve equality between exports and imports. It is not a matter of maintaining equilibrium in the balance of payments with the other country by canceling the deficits in the financial balance with the surpluses in the capital balance, but the balance of each balance within the balance of payments with the other country by individual.

For the same reason, under a floating exchange rate regime, the equilibrium on the trade balance between two A and B countries can not be maintained as long as there are deficits or surpluses in the trade balance of one of the two countries, say B with a third country C, because that would be generating in that country B economic instability in the long term by allowing the growth of debt with some country C. The economic instability of country B with country C, would affect country A when collapse the economy of country B and with that its imports and exports with country A. The same reasoning applies for the balance of payments.

In conclusion, country A should not trade with another country B that does not undertake to maintain the equilibrium of its balances within the balance of payments with each of the other countries per individual.

What is true of the international trade of country A with country B, must also be the true of country A with all other countries per individual.

5. Consequently, under a floating exchange rate regime, any country A that aspires to obtain the optimal economic benefit from its international trade with multiple countries B, C, etc., while maintaining its long-term economic stability as its goal or objective, should aim to maintain the individual equilibrium of all the balances within the balance of payments with each country per individual and this includes the income balance within the current account balance. It is not, therefore, a matter of maintaining equilibrium in the balance of payments by neutralizing the deficits with one country with the surpluses of another country. Neither is it a matter of neutralizing deficits in the trade balance with surpluses in the financial balance or in the capital balance. In addition, it should not trade with a country that does not undertake to do the same with third countries.

The understanding of this dynamic allows to complete the theory of comparative advantages on international trade.

VI Application of the Theory of Comparative Advantages Completed

We have argued that for a country A to establish a floating exchange rate regime with country B in order to achieve the exchange rate that reach the equilibrium of the trade balance, that

country needs to regulate the flow of capital, so as to keep the equilibrium in the finance balance, the capital balance and the income balance within current account balance. Otherwise, the floating exchange rate regime will not produce the exchange rate that balances exports with imports on the trade balance.

It is therefore for governments to establish regulations on the mobility of capital within each country to achieve the objective of maintaining balance of the financial balance, the capital balance and the income balance within the current account balance, leaving the foreign exchange market determine the equilibrium exchange rate for the trade balance.

However, because the developing countries tend to devalue their currency and encourage foreign investment to accelerate economic development, trying to establish a regime of floating exchange rates and capital mobility regulations may not be very effective for achieve the goal of balancing the trade balance, the financial balance and the capital balance due to the resistance of the countries to fulfill these objectives voluntarily. Instead, the ideal is to identify faster and more effective ways of achieving equilibrium in the trade balance, the financial balance, the capital balance and the income balance within the current account balance between two countries. One way of doing this is to determine by any means the equilibrium exchange rate of the trade balance and establish it in a binding manner by agreement between both governments of countries A and B. As for the other balances within the balance of payments you can proceed in the same way. That is to say, determine by any means the measures that balance the financial and capital balance and establish it in a mandatory way by agreement between both governments of countries A and B.

In what follows we will have to discuss how to regulate the determination of the equilibrium exchange rate of the trade balance between two countries A and B. Later we will discuss how to regulate the other balances within the balance of payments.

VII Proposal to Establish a Regulatory Bank of International Trade that Replace the IMF and Whose Mission is to Determine the Exchange Rate of Equilibrium of the Trade Balance Between Countries

In order to achieve the objective of keeping the balance of trade of the countries in equilibrium, we propose the creation of a Regulatory Bank of International Trade (RBIT). To achieve this objective, country A, members of the bank, who have a trade deficit with another country B, also member of the bank, undertake to allow RBIT to charge a tax on each exchange of country A currency for country B currency made by the citizens or institutions of the country A. The tax payable would be the one that allows establishing the equilibrium exchange rate between both countries.

Country B, member of the bank, who have a trade surplus with another country A, also member of the bank, undertake to allow the RBIT to grant a credit on each exchange of currency of country B by currency of country A made by citizens or Institutions of country B. The credit to

be paid would be that which establishes the equilibrium exchange rate between the two countries and would be financed with the taxes charged to the deficit country A.

In this way, the RBIT would be transferring the taxes collected in country A to the citizens of country B. This operation would have the effect of appreciating the currency of country B relative to the currency of country A and depreciate the currency of country A relative to the country B currency. Consequently, imports from country A would be reduced and imports from country B would be increased until the balance of trade between the two countries reach the equilibrium.

This simple measure is exactly equivalent to the determination of the exchange rate under a floating exchange rate regime.

The tax and credit established by the RBIT would be reviewed every six month to determine their effectiveness in relation to the goal of balancing the trade balance between both countries. Failure to reach the objective would increase the tax and credit in percentage terms until there is a balance in the trade balance of both countries.

The exporting country B would have the option of appreciating its currency with respect to country A in the same percent of the tax established by the RBIT. In this way country A would get rid of paying the tax and country B to receive it.

By this means, it would be forcing all countries to establish exchange rates that would be equivalent to floating exchange rates that balance the trade balance of each country with that of all countries considered per individual.

RBIT member countries should not trade with countries that are not RBIT members. If they do and generate a deficit in their trade balance with countries outside the RBIT that threatens their economic stability, then could be removed from the RBIT.

Countries that do not want to threaten the production of strategically important goods, such as fuel or armaments, would have the obligation to subsidize them.

VIII Disconnection of the Monetary Policy and the Interest Rate of International Capital Mobility

In the previous sections we discussed how, in a floating exchange rate system, imbalances in the financial balance, the capital balance and the income balance within the current account balance, produce changes in the supply and demand of currencies that affect the determination of the rate of exchange that balances the trade balance. For this reason we conclude that under a floating exchange rate regime, the equilibrium exchange rate that equates exports with imports between two countries could only be achieved by maintaining the equilibrium in the

financial balance, the capital balance and the income balance within the current account balance, in conjunction with the trade balance.

However, the equilibrium exchange rate in the trade balance can be determined using other mechanisms that are not based on the supply and demand of foreign exchange in the market. An example of this is the one we offered in the previous section where we discussed the establishment of the Regulatory Bank of International Trade RBIT. This solution disconnects the determination of the equilibrium exchange rate of the trade balance of the foreign exchange market. Consequently, with this solution we present, it is unnecessary to have to balance the other balances within the balance of payment of each country, since they will not affect the determination of the equilibrium exchange rate in the trade balance directly. When we say directly, we mean that the imbalances in the financial balance and the capital balance would not prevent RBIT from determining, by means of taxation, the equilibrium exchange rate of the trade balance. However, it indirectly affects the extent to which the imbalances in the financial and capital balance would force the RBIT to modify the tax to be imposed on country A and the credit to be granted to country B.

Although the determination of the equilibrium exchange rate of the trade balance by the RBIT does not require that the financial and capital balance be in equilibrium, however, there are other reasons why it would be desirable to maintain the equilibrium of balances within the balance of payments. For example, one reason why it would be desirable to maintain equilibrium in other balances within each country's balance of payments is to disconnect the monetary policy and the interest rate of each country from fluctuations in the international capital markets. This disconnect allows countries to have a very important tool to combat inflation and levels of production and employment through monetary policy and the interest rate of each country.

Another reason is to avoid the loss of jobs caused by deficits in the capital account with developing countries that have a poor income distribution, that is, low wages.

Another reason is to avoid the instability cause by the surplus in the financial balance by increasing savings above the economy capacity to absorb the saving ECAS and propitiate recession.

IX How Can You Maintain the Equilibrium in the Financial and Capital Balances?

If countries did not need foreign investment, it would be easy to solve the problem created by imbalances in the financial and capital balances on the equilibrium exchange rate. It would suffice to prohibit the purchase of assets or foreign direct investment so that it will not affect the equilibrium exchange rate of one country with the others. However, countries need loans and foreign investment for a variety of reasons. For example, poor countries need foreign investment to acquire state-of-the-art technology.

Consequently, the solution lies in maintaining a capital balance in equilibrium where foreign investment in the country equals foreign investment abroad, so that capital flows can be neutralized and prevented from interfering with monetary policy and the interest rate of the countries and to prevent it from interfering indirectly with the equilibrium exchange rate in the trade balance by altering the tax that has to be established by the RBIT.

But this solution requires governments to exercise control over loans and investments in and out of their country. As we know, this conflicts with the current policy of the United States and the governments of the world established at the Bretton Woods conference to promote the free movement of capital at the international level, with the dollar as the international payment currency.

The United States must therefore reject this policy which, while it has favored them in the short term, has in the long run increased instability and economic recession in the United States by increasing foreign debt.

The policy of maintaining the free mobility of capital, while benefiting entrepreneurs in the United States, harms the population by generating instability through imbalances in the financial and capital balance. In addition, it harms the economy by linking the US interest rate and monetary policy to the balance of payments swings. This connection made it difficult for the government to establish a monetary policy to control recession or inflation in the United States by denying it a vital instrument.

Consequently, the United States should convene a new conference of the countries of the world to end the International Monetary Fund and the World Bank and replace them with other international banks with new targets or to modify the current goals of the International Monetary Fund and the World Bank and adjust them to the purpose of a greater degree of control over the economic stability of the countries in the long term.

X Proposal to Establish a Regulatory Bank of International Mobility of Capital that Replace the IMF and the WB and Whose Mission Will be Balance the Income Balance Within the Current Account Balance, the Financial Balance and the Capital Balance Between Countries

In order to keep the equilibrium of the income balance within the current account balance, the financial balance and the capital balance of the countries and to disconnect the monetary policy and the interest rate of the countries from the swings of the financial markets of international trade, we propose the creation of a regulatory bank of the international mobility of capital (RBIMC).

The purpose of the RBIMC would be to achieve the equilibrium in the income balance within the current account balance of each country with the other countries by individual. That is, to achieve the equilibrium of the income balance within the current account balance of country A

with country B, C, D, etc. by individual. In order to achieve this objective, it should discourage or stimulate, as the case may be, the surpluses or deficits in the financial balance and the capital balance of the country A with the countries B, C, D, etc. so that the loan or investment stocks of each country are reduced or increased with the other, and with it the deficits or surpluses in the income balance within the current account balance. The balance of income within the current account balance has two components. The income received by interest on the loans that one country gives to the other and the income received by the profits on the investments that one country makes on the other. Both incomes depend in turn on the loan and investment stocks that each country has in the other. To the extent that the RBIMC is able to generate imbalances in the financial balance and the capital balance of country A with each country B, C, D, etc., it will generate changes in loan or investment stocks, as the case may be. That is to say, these disequilibrium in the financial and capital balance will bring about changes in the loan stock and the investment stock of country A with country B, C, D, etc. which are consistent in the long run with the equilibrium in the income balance within the current account balance, as well of equilibrium the financial balance and the capital balance of country A with country B, C, D, etc.

XI Action of RBIMC that Cause Changes in the Financial Balance that Induce Equilibrium in the Income Balance Within Current Account Balance

To achieve the objective of keeping the equilibrium of the income balance within the current account balance, country A, members of the bank, who have a surplus of the income balance within current account balance with another country B, also a member of the bank and that this surplus comes from an excess in the payment received from interest, above payment made of interests due to differences in the loan stocks of each country in the other country, undertake to allow RBIMC to collect a tax on repatriated interest from country B as a result of the loan stock granted by country A to country B. The tax to collect would be established in percentage terms and would depend on the magnitude of the surplus of the income balance within the current account balance of the country A with country B. If the income balance within the current account balance is in equilibrium the tax to collect would be zero percent. As the surplus increases, as a result of the difference between the loan stocks of both countries, the percentage tax will increase until it reaches 100% and the benefit of country A from the interest charged to country B will disappear. It is to be expected that this measure would discourage the establishment of more loans from country A in the country B and thereby discourage the growth of the surplus in the income balance within the current account balance of country A. Discouraging the granting of more loans from country A to country B will have to be reflected in the tendency to equalize the loan stock of country A with the loan stock of country B.

The tax collected by RBIMC on country A would be credited to the interest on loans granted by country B to country A. It is to be expected that this measure will stimulate the granting of loans from country B to country A and would be financed with the taxes charged to country A who have the surplus in the income balance within the balance of current account. By

stimulating the granting of loans from country B to country A will be reflected in the tendency to equalize the loan stock of country B with the loan stock of country A.

As can be seen, both measures would tend to balance the income balance within the current account balance between the two countries in the long term.

The tax charged by the BRMIC, by discouraging the establishment of more loans from country A to country B, it will have to induce imbalances in the financial balance of the country A in the short and medium term, but in the long term will tend to balance as the income balance within the current account balance approaches equilibrium.

Of course this measure would not apply to pre-established loans. It would only apply to new loans to be established.

The tax and credit established by RBIMC would be reviewed at six months to determine its effectiveness in relation to the goal of balancing the loan stocks between both countries and with that to balance the income balance within the current account balance between both countries. Failure to do so would increase the tax in percentage terms until there is equilibrium in the income balance within the current account balance of both countries.

XII Action of RBIMC that Cause Changes in the Capital Balance that Induce Equilibrium in the Income Balance Within Current Account Balance

To achieve the objective of keeping the income balance within the current account balance in equilibrium, country A, members of the bank, who have a surplus in the income balance within the current account balance with another country B, also a member of the bank and that this surplus comes from an excess in the payment received from profits, above payment made of profits due to differences in the investment stocks of each country in the other country, undertake to allow RBIMC to collect one tax on profits to be repatriated from country B as a result of the stock of investments made by country A to country B. The tax to be collected would be established in percentage terms and would depend on the magnitude of the surplus of the income balance within the current account balance of the country A with country B. If the income balance within the current account balance of country A is in equilibrium the tax to collect would be zero percent. As the surplus increases, as a result of the difference between the investment stocks of both countries, the percentage tax will increase until it reaches 100% and the benefit that country A obtain from the profits obtained from the investments in country B will disappear. This measure can be expected to discourage the investment of country A in to country B and with this the growth of the surplus in the current account balance of country A. Discouraging the seated of more investments from country A to country B will have to be reflected in the tendency to equalize the investment stock of country A with the investment stock of country B.

The tax collected by RBIMC on country A would be credited to the profit on investment by country B to country A. It is to be expected that this measure will stimulate the investment from country B to country A and would be financed with the taxes charged to country A who have the surplus in the balance of current account. By stimulating the investment from country B to country A will be reflected in the tendency to equalize the investment stock of country B with the investment stock of country A.

As can be seen, both measures would tend to balance the income balance within the current account balance between the two countries in the long term.

The tax charged by the BRMIC, by discouraging the establishment of more investment from country A to country B, it will have to induce imbalances in the capital balance of the country A in the short and medium term, but in the long term will tend to balance as the income balance within the current account balance approaches equilibrium.

Of course this measure would not apply to investments previously established. It would only apply to the new investments that will be established.

The tax and credit established by the RBIMC would be revised every six months to determine its effectiveness in relation to the goal of balancing the investment stocks between the two countries and thereby to balance the income balance within the current account balance between both countries. Failure to do so would increase the tax in percentage terms until there is an equilibrium in the income balance within the current account balance of both countries.

Note that by RBIMC intervention, country B receiving the loan or investment from country A would benefit because it retains within its economy the interest and profits from foreign country loans and investments that exceed the interest and profits of the loans and investments of country B in the foreign country A and vice versa. In this way, no country could benefit from the exploitation of another.

XIII Possibility of Maintaining the IMF and Eliminating the RBIMC

As we have pointed out, RBIT mission is to keep the equilibrium in the trade balance of the countries and the mission of the RBIMC is to maintain the equilibrium in the income balance within the current account balance of the countries. If the United States were unwilling to cede the benefit of maintaining the dollar as an international means of payment, they could choose to omit the RBIMC and replace it with the IMF. In such a case, the RBIT would maintain its functions to balance the trade balance and the IMF would maintain its functions of lending to countries that will need dollars, which would be reflected in deficit in the financial balance of the United States with countries that take loans. Interest payments on these loans would be reflected in surpluses on the income balance within the current account balance of the United States with borrowing countries. These surpluses in the income balance within the current

account balance would in turn mark a difference between GNP and the GDP of the United States. That difference between GNP and GDP, that is, the interest obtaining by the United States of the deficit in the financial balance with borrowing countries, would be what the United States would obtain as a benefit of maintaining the dollar as a means of international payment. However, to the extent that the debts of the countries to which the United States lends them money through the IMF grow, and to the extent that the difference between GNP and GDP of the United States increases, to that extent economic instability in the long run will be growing in those countries. The economic recession of the other countries will adversely affect the United States economy by reducing its foreign trade.

By this formula, the United States could not benefit from trade balance deficits because the RBIT would prevent it, but it could benefit in the short and medium term from deficits in the financial balance and the deficits of capital balance.¹

Conclusion

The United States maintains and promotes the policy of free movement of capital at the international level. At the Bretton Woods conference after World War II, the United States supported and encouraged the free movement of capital at the international level. This supposedly benefited the United States in the expectation that the dollar would become the currency of international payments. In addition, they allowed trade deficits in their trade balance to benefit from lower prices and benefit from a debt that has as a characteristic that a part of the debt is not paid to the extent that the dollar is maintained as the currency of international payments. But this decision only considered the benefit that the United States would derive from the international capital movement and of trade deficit in the short and medium term and did not take into account the detriment of that decision in the long run. In seeking to benefit from the international capital movement and of international trade deficit in the short and medium term, the United States sacrificed its internal stability in the long run by encouraging the uncontrolled growth of its external debt and encouraging the uncontrolled growth of the external debt of the other countries to which it lends money through the IMF. In addition, by allowing a devalued exchange rate against the dollar, the United States allows the loss of its comparative advantages of some of its goods in which the other country acquires the comparative advantage. This has the negative effect of producing job losses in the United States. On the other hand, when the United States takes borrowed money from the countries with which they maintain deficits in their trade balance, they generate uncontrolled growth of the long-term internal savings in the United States. Finally, by promoting and maintaining a policy of free movement of capital, they sacrifice the capacity of maintain the control of its monetary policy. Through the commitment to maintain the fixed exchange rates tied to the

¹ For a discussion of the benefits the United States obtains from maintaining the dollar as an international means of payment see [Proposal to Combat Recession in the United States by Modifying Imbalances in the Different Components of Its Balance of Payments with Mexico and China](#) by Walter H. Bruckman. Document that can be downloaded from the internet at the address: Consultando.Net.

dollar that the countries made through the international monetary fund, the monetary policy and interest rates of the countries were tied or connected with the imbalances in the financial and capital balance.

In other words, in return for the sacrifice of generating economic instability in the long run within their economy, the United States obtains lower prices on its foreign purchases and obtains a growing external debt where part of the external debt would not have to be paid in the extent to which dollars involved in the trade balance deficit are kept outside the United States by circulating as an international means of payment. The external debt is now very large and its constant growth threatens the stability of the economy. It is necessary for the United States to modify this policy of free trade and free capital mobility in order to seek more economic stability with less accelerated but sustainable growth over time. That is, the United States needs to eliminate the deficits in its trade balance with China, Japan, Mexico, Canada Germany, etc. and to eliminate the policy of free capital mobility.

Consequently, the United States should therefore call for a second Bretton Woods conference to establish a new international trade order aimed to achieve at long-term economic stability.

Appendix

XIV The Loss of Jobs in the United States Due to Surplus of Capital Balance

When a country A devalues its currency with respect to country B and maintains the fixed exchange rate above the equilibrium exchange rate, in order to maintain a surplus in its trade balance, it happens that some goods where country B has comparative advantages under the equilibrium exchange rate, no longer have comparative advantages under the new exchange rate that is above the equilibrium rate. In that case country A would have comparative advantages in these goods and that is one of the factors that allows it to increase its production and consequent export. Consequently, firms in country B that no longer have comparative advantages would have an incentive to move their output to country A that now has the comparative advantages and to generate a surplus in the country A capital balance. Whether they do it or not depends on multiple factors, such as the security of the companies in country B affected by the depreciation of the currency of country A, that country A will maintain its policy of devaluing its currency and maintaining the fixed exchange rate for time undefined. That is, the commitment that country A has in order to keep its currency devalued and the exchange rate fixed indefinitely. It will also depend on the policy of country A regarding allowing foreign investment in its territory. It will also depend on the expectations of businessmen in country B that their country does not hinder the entry of goods produced in country A, in case they move their operations to country A. It will also depend on whether country A already has established in their territory a national industry in which they now

acquire or improve their competitive advantage. It will also depend on whether country A has a poor distribution of income, that is, lower wages than country B. The worse the distribution of income, that is, the lower the wages of country A compared to country B, the greater the incentive of entrepreneurs in country B to transfer their operations to country A while maintaining the sale of their production in country B as this allows them to have better profit margins in the price of their merchandise or more competitive prices in their own country or both. Conversely, if country A had an equal or better income distribution, that is, wages equal to or better than country B, then firms in country B would have less incentive to move their operations to country A.

The United States maintains a deficit in the trade balance with Mexico, China, Canada, Japan and Germany, implying that these countries maintain a policy of devaluing their currency against the dollar and maintaining their fixed exchange rate. This is an incentive for companies in the United States that lose their comparative advantages over those countries, to move their operations to those countries. Whether or not they do so will depend, as we have pointed out, on many factors. In the case of developing countries such as Mexico and China, with the need to acquire investment and state-of-the-art technology and with very low salaries compared to the United States, that is what has happened. That is why the balance of capital of the United States with Mexico and China is in deficit. In the case of developed countries, such as Japan and Germany, this has not happened, perhaps because the policies of these countries regarding foreign investment vs. national investment have not led to it or perhaps because they have national investments in those areas that they want to protect or perhaps because they are countries with a good income distribution, that is wages similar to that of the United States and, consequently, the United States companies do not find it attractive to change their operations to those countries.

XV The Unknown Variable that Causing Recession: The Productivity Growth

There is one variable that has historically been absent from economic analysis, both in macroeconomic models, and in international trade models. That variable is the level of the needs of the different goods. Each type of good satisfies a type of need. The needs of the different goods have a maximum beyond which the quantity demanded will not be increased even if the price is continued to fall. That is, their demand becomes perfectly inelastic from a certain amount onwards. However, economic theory does not consider in the analysis this maximum in the needs of the goods. Consequently, macroeconomic theory, as well as international trade theory, implicitly assumes that, if the level of productivity increases, consumption and, consequently, aggregate demand will increase in the same proportion. This is a mistake.

If productivity in the United States increases by 3% per annum and wages remain the same, consumption should not increase much, and consequently neither aggregate demand, which is why we can expect a recession to occur. However, even if wages increase at the same rate as productivity at 3% a year, consumption will not necessarily increase unless new products

emerge and consequently new needs to be met or unless the quality of the existing goods is increased and consequently their corresponding price. This is because the levels of consumption of the existing goods can be at their maximum level or close to the maximum level. The more years go by, the greater the effect of a deficient creation of new products and new needs to satisfy that compensate for the increase in productivity and wages. In 10 years the 3% annual increase in productivity and wages would be 30%. Consequently, if the creation of new products or the creation of improvements in the quality and price of existing products and, consequently, the growth of new needs, does not go hand in hand with that increase, we can expect a recession every 10 years.

This variable is so important that to avoid recessions every 10 years there should be a ministry in every country in charge of promoting and stimulating the creation of new products and new needs to satisfy. Otherwise, working hours in enterprises should be reduce as the gap between increases in productivity and the creation of new products and needs increases. If we do not proceed from one of these two forms, cyclical recessions every ten years will be repeat.

In the case of international trade the same reasoning applies. The theory of comparative advantages shows that as countries develop their foreign trade by specializing in the production of goods in which they have comparative advantages, to that extent the joint productivity of both countries increases. As a result, increases in productivity generated by the development of foreign trade will cause recessions to the extent that real wages are not increased and new products and new needs are not created, in the same proportion as productivity increases.

But as we have pointed out, this variable is absent in the models on national economy and on international economy. Consequently, the recession experienced by the United States as a result of deficits in its trade balance and surpluses in the financial balance, would not necessarily be avoided by balancing these two balances. It is necessary to create a government agency on charged with raising real wages and encouraging the creation of new products at the same rate as productivity increases.

XVI The Interrelation Between External Equilibrium and Internal Equilibrium

To solve the problem of a level of increasing savings (surplus production) in developed countries, entrepreneurs have depended on increasing their investments abroad. It is from this need that the idea of promoting the free movement of capital arises and, consequently, the deficit in the capital balance. Consequently, to the extent that the RBIMC action are successful and reduce the income balance within the current account surplus and the deficit in the trade balance, to that extent external imbalances will be corrected and internal imbalances between savings and investment will arise. Therefore, to the extent that the policy of RBIMC of maintaining the equilibrium of the income balance within the balance of current account and the balance of capital does not allow for an increase in investments abroad, to that extent the level of savings in the domestic economy must be reduced by increasing wages, that is, improving the distribution of income within the domestic economy in order to avoid recession.

XVII The Automatic Increases in Quality and Price of Financed Goods

It can be seen that, in response to increases in productivity and the consequent increase in consumer incomes, an increase in the quality and price of certain types of goods occurs over time. These are the goods that are financed, such as housing, cars, electrical appliances, furniture, etc. The banks and companies that finance this type of consumption use financing criteria that are usually fixed percentages of the income of the people. For example, housing financing is typically 25% to 30% of consumer income, auto financing between 10% and 12% of consumer income, and the same with respect to furniture and appliances that are usually a fixed percentages of the income. Consequently, when productivity increases and thus the income of consumers, what usually happens is that the price of homes, cars, appliances, etc. increases in proportion to the increase in income so that the percentages of financing remain the same over time. Consequently, this type of consumption should not be affected by increases in productivity and the consequent increase in income, since the goods of this type that are financed are constantly renewed by increasing the quality of the product and its corresponding price in proportion to the increase in productivity.

If we assume that the financed consumption is between 50% and 60% of the consumers' income, then from 50% to 40% of the not financed consumption of goods generate a deficient demand when the productivity and income of the people increases. It is therefore necessary to produce new goods or improve the quality of existing ones so that increases in productivity and income do not produce recession.

XVIII Cause of Recessions in the United States

What causes recessions in the United States is the steady growth of savings (A) above the economy's capacity to absorb savings (ECAS). The increase in savings has three causes: 1. The deterioration in the distribution of income, 2. The increase in new products and, consequently, new needs in a smaller proportion than the one increased in productivity and the income, 3. The deficit in the trade balance and the surplus in the financial balance.

1. First, the growth of this savings arises from the worsening income distribution that reduces the proportion of income that is consumed in an induced manner by concentrating income in few hands with few needs to satisfy other than to increase the production through investment, which further increase savings. The worsening income distribution arises from the fact that wages do not rise at the same rate as productivity increases.

2. Second, the growth of savings also arises from the fact that, although wages increase in the same proportion as the increase in productivity and, consequently, the distribution of income does not worsen, it happens that productivity increases in a

proportion greater than the increase or creation of new products that generate new needs to satisfy. That is to say, new products emerge and consequently new needs to satisfy by increases in income (wages and profits) but the increase in new products and consequently new consumption and investment needs is proportionally less than the increase in productivity and, consequently, the increase in the level of income. This is the case we discussed in the previous section.

3. Third, the growth of savings arises from the fact that, in the short term, deficits in the US trade balance return through surpluses in the United States financial balance as foreign loans to the United States government through the purchase of assets to the treasury department and as loans to the rest of the population through private banks. This transfer of dollars from abroad to the circular current of income in the United States increases in the short term the savings available in the United States.