

The Case for Fixed Exchange Rates, 1969

CHARLES P. KINDLEBERGER

Students of current Federal Reserve literature may recognize that I have borrowed the title of this paper, — with one important change — from an article by Harry G. Johnson in the June issue of the Chicago review of the Federal Reserve system, published by the Federal Reserve Bank of St. Louis.¹ I do not propose to argue with the Johnson paper point by point, although its author is kind enough to make the case for fixed exchange rates before knocking it down. I may be permitted, however, to quote three sentences from it, to agree with one and a portion of another, and to express what I hope is reasoned dissent from most of two:²

- (1) “the case for fixed rates is part of a more general argument for national economic policies conducive to international economic integration (p. 14)”. I agree with this.
- (2) “The fundamental argument for flexible exchange rates is that they would allow countries autonomy with respect to their use of monetary, fiscal and other policy instruments. . . by automatically ensuring the preservation of external equilibrium (p. 12).”
- (3) “A flexible exchange rate is not a panacea [agreed,cpk]; it simply provides an extra degree of freedom, by removing the balance of payments constraint in policy formation (p. 23).”³

¹See Harry G. Johnson, “The Case for Flexible Exchange Rates, 1969,” Federal Reserve Bank of St. Louis, *Review*, Vol. 51, No. 6 (June 1969), pp. 12-24. (Also published by the Institute of Economic Affairs, along with a paper by John E. Nash, under the title “UK and Floating Exchanges,” *Hobart Papers*, No. 46, London, May 1969). Note that Johnson borrowed his title from Milton Friedman, whose paper is noted in footnote 4 below.

²I choose not to cavil at what I consider as small imperfections in the paper, e.g. the contradiction between the suggestion on p. 18 that sterling should belong to a fixed-rate bloc — either the dollar or some continental currency run by the EEC — and the conclusion on p. 24 that the pound should float; or the disingenuous suggestion, in the light of the history of moral suasion by Federal Reserve authorities, that if the authorities know something that the speculators do not know, they can calm speculative fears by making that knowledge public.

³See Egon Sohmen, *Flexible Exchange Rates*, 2nd ed., Chicago, University of Chicago Press, 1969.

Mr. Kindleberger is Professor of Economics, Massachusetts Institute of Technology, Cambridge, Massachusetts.

International economic integration is presumably regarded as a benefit, but loss of autonomy under fixed rates is a cost which outweighs it. Or under flexible rates, the benefit of an additional degree of freedom for domestic macro-economic policy is greater than the loss from suboptimal world resource allocation resulting from the separation of national markets for goods and factors. This sets the terms of the debate in which I propose to show that the extra degree of freedom sought by Johnson is illusory. But note that the case is often made, for example by such an advocate as Sohmen, that the fixed-exchange rate system breaks up world markets because national policies cannot be sufficiently harmonized to operate it without controls, whereas flexible exchange rates, plus forward markets, produce world economic integration. There is a hint of this position in the Johnson paper when he expatiates on the propensity of the market mechanism to produce exactly the kind of forward trading to eliminate exchange risk in a world of flexible rates, and this must be dealt with. The question is whether flexible exchange rates are a second-best solution in a world of frail men blown about by political winds to an extent that the first-best solution of a single world money is unattainable, or whether they constitute a first-best solution in their own right.

A Universal Versus Qualified Flexible-Exchange Rate System

Johnson's paper fails to make a distinction between a universal flexible-exchange rate system and the adoption of flexible exchange rates by one or more individual countries in a world where at least one major currency is fixed or passive. Nor was this distinction originally made by Milton Friedman in his famous *Essay in Positive Economics*⁴ which Johnson cites in glowing terms, an omission which, as Professor Friedman now magnanimously concedes, has been productive of much confusion.⁵ With his present understanding of the point, Friedman has modified his original advocacy of a system of flexible exchange rates in favor of flexibility for any country that wants it, but specifically not for the United States and

⁴Milton Friedman, "The Case for Flexible Exchange Rates," in Milton Friedman, *Essays in Positive Economics*, Chicago, University of Chicago Press, 1953, pp. 157-203, abridged in R.E. Caves and H.G. Johnson, eds., *Readings in International Economics*, Homewood, Ill., R.D. Irwin for the American Economic Association, 1968, chap. 25.

⁵See his discussion in F. Machlup, chairman, "Round Table on Exchange Rate Policy," in *American Economic Review, Papers and Proceedings*, Vol. LIX, No. 2 (May 1969), pp. 265 ff.

presumably not for small ones. (Banana republics are also exempted by Johnson on the ground that they do not have the illusion that the price of bananas in local money is a major determinant of the cost of living, as contrasted with the price of imported goods).

Friedman's change of view, overlooked by Johnson, led to the curious result last May in a television debate between Friedman and Samuelson, which I had the honor of chairing, that I agreed with Friedman on flexible exchange rates, Samuelson agreed with Friedman, and Samuelson disagreed with me. The resolution of this inequality, of course, was that, integrated over time, Friedman had two positions, and Samuelson and I each only one.

The extra degree of freedom which a country obtains by adopting a flexible exchange rate does not come full-blown like Athena from the brow of Zeus. It is not created by an economist-chemist in his study or laboratory. There is no free lunch, and we are still some distance from perpetual motion. Either the country itself abjures from interfering in exchange market; or its trading partners — or some major trading partners — abstain from interference while the country itself intervenes; or exchange rates are agreed internationally. In the last instance, of course, there is no extra degree of freedom for anyone, and wrong rates may persist unaltered because of failure to cooperate in changing them, as in the French-German confrontations of November 1968 and March 1969. Where a country itself forebears from affecting its exchange rate, using rules instead of management, as Professor Friedman would say, or locking the door and throwing the key away, as it appears to me, the gain in autonomy for monetary and fiscal policy is an illusion. Along with one more variable, there is one more target — the exchange rate. Where a large country agrees to let the country with a floating rate set whatever rate it wants, the freedom for one comes from a loss of freedom for the other.

Freely Fluctuating Rates

Let me dwell for a minute on the case of an exchange rate which is freely fluctuating with no official intervention. It is implicit in the case for floating rates that the "external equilibrium," which comes from allowing the supply to equal the demand for foreign exchange in a free market, is equilibrium not only for the balance of payments but also for other macro-economic parameters — prices, wages, employment, interest rates, etc. There is no justification for this

view. A foreign exchange rate may clear the market for foreign exchange but exert pressure upward or downward on prices, employment, and so on.

In Canada, the floating exchange rate was abandoned because an overvalued rate exerted great deflationary pressure on the Canadian economy. Adherents of the flexible exchange rate system, Canadian and foreign, dismiss this case contemptuously as the result of the monetary foibles of one central banker whose monetary policy was mistaken. This will not do. The case demonstrates that a fluctuating exchange rate may not give monetary autonomy but provides another parameter to be controlled in managing the domestic economy. Mundell has said somewhere that floating exchange rates require more careful attention to monetary policy, rather than provide autonomy, because if capital continues to move across a floating rate, in response to changes in interest rates — as was true in the Canadian instance — low interest rates will depress the exchange rate, and high ones raise it. There may be possibilities of fine tuning here, but there is surely not autonomy.

But suppose capital moves not in response to domestic interest rate changes but autonomously — because capitalists do not like government policy in the nationalization of electricity (Italy, 1963), or because of student-worker riots (France, May-June 1968). The list is endless and includes most recently a loss of one-third of the Danish reserves in five days in May 1969, or a Belgian loss of \$300 million (15 percent of its reserves) in two weeks at the time of French devaluation in August 1969. The balance of payments would be cleared by depreciation, but the new and lower rate would be likely to undervalue the currency and stimulate possibly irreversible rises in wages and prices. It is of some interest that a well-known advocate of a floating rate for the United Kingdom, Samuel Brittan, notes that it is important to float a currency at the right time, “with very careful internal preparation.”⁶ Where is the gain in autonomy?

⁶See his “U.K. External Economic Policy,” a draft paper prepared for the International Economic Association Conference on Mutual Repercussion of North American and Western European Economic Policies, held in Algarve, Portugal, August-September, 1969, p. 7:

“The great fear about a floating pound is that in the transitional period, while the current balance is deteriorating, the rate would be entirely dependent on stabilizing speculation. If the market took a pessimistic view and import prices rose severely at a time when inflationary expectations were very high, there would be, it is feared, a risk of a cumulative cycle inflation and exchange depreciation on almost a Latin American scale. To offset such cost-inflationary forces by financial policy might require very severe unemployment if it were manageable at all.”

Where the country retains control over its exchange rate and can intervene to prevent short-run movements which might work at cross purposes with domestic policy, it obtains its extra degree of freedom — if it in fact acquires it — at the expense of some other country. This is the well-known N-1 problem which makes it evident that a system of N flexible exchange rates for N countries is overdetermined. If one (major) country gives up its control of the rate, the extra degree of freedom of the others is produced, not from thin air, but by transfer. Johnson may be urging other countries, and especially Britain, to move to a flexible-exchange-rate system and leave the United States stuck with whatever rate the reciprocal of the N-1 countries produces. If so, he should stop worrying about the “deficit” in the United States balance of payments, on which he has written so fully, since having lost an instrumental variable, the United States must also give up a target. And he should be aware that he is condemning certain import-competing industries to rather more rapid extinction than they otherwise attend, since it is likely that other countries will continue to embrace slightly undervalued exchange rates, export surpluses, and gains in reserves. I gather that the “new” Professor Friedman is willing to accept the logic of this position, and so am I.

If Johnson wants flexible exchange rates with coordinated intervention by various countries, it is hard to see how different this is from the present position where we try, but fail, to get disequilibrium rates changed by mutual agreement. This is a bargaining or game-theoretic problem with a non-zero solution.⁷ It is good that the French finally did devalue in August, and unhappy that the Germans did not seize the occasion to revalue the DM upward. The French had had a problem (DeGaulle) which had made it difficult for them to devalue, and the Germans continue to have strong political forces opposed to revaluation. It is difficult to speak on these matters on which we have little experience, but my intuition tells me that fixed rates with discontinuous changes in parities which are out of line (admittedly not yet a workable system) are as easy or easier to operate than continuous cooperation on continuously moving rates.

⁷Note that circumstances are more important than principle in these matters. In 1932 sterling was flexible and the dollar fixed; Britain opposed currency stabilization and the United States favored it. After the abandonment of the old gold price in March 1933, British official opinion saw the need for currency stabilization, and the United States moved into opposition.

Partial and General Equilibrium

Economists frequently confuse partial and general equilibrium. In partial equilibrium everything else is unchanged. Demand and supply clear the market for a commodity without effects on other demands, supplies, national income, prices, wages, etc., or with effects so small that they can be safely ignored. The theoretical argument for flexible exchange rates comes from the application of partial-equilibrium analysis in which *ceteris* are *paribus*; or from an analysis which is converted from partial to general equilibrium by one or more heuristic devices which may be legitimate in teaching but can be applied to the real world only at great risk.

Such a device, for example, in a two-country, two-commodity world is to fix exports in physical terms in each country so that one unit of exports costs one unit of the domestic currency, both before and after changes in the exchange rate. This builds money illusion and exchange illusion into the system. Or the exchange-rate change is made to produce an alteration in the balance of payments by means of assumed appropriate changes in spending in the system, working in the background to change incomes in the direction needed. Or depreciation raises real interest rates which cuts spending.

In all these formulations, it appears that the balance of payments is being maintained by changes in the exchange rate, but other real variables must be manipulated in the background in the right direction and amount to achieve the final result. The extra degree of autonomy is again illusory, resulting from the addition of a variable, the exchange rate, as if it were independent of other parameters in the system, and there were no feedbacks. It must be recognized that the exchange rate in most countries, and especially those where foreign-traded goods, whether exports or imports, enter significantly into the cost of living, is such a pervasive parameter, linked to prices, wages, credit conditions, taxes, etc., that it cannot be treated like the price of potatoes.

In the third quotation above, Johnson goes on to say:

... a flexible exchange rate "does not and cannot remove the constraint on policy imposed by a limitation of total available national resources and the consequent necessity of choice among available alternatives; ..."

How true. Disequilibrium in the balance of payments of an ordinary country — I do not speak of the special problem of a financial center

— is the result of one or more of the following: excess spending, excess money creation, too low a rate of interest, too high prices, too high wages, distrust of the currency.

The first-best policy is to correct the cause of the disequilibrium. Exchange depreciation eliminates a deficit in the balance of payments only as it works to produce a change in the real value of one or more of the parameters, i.e. as it works to cut the real value of money, wages, spending, etc. It assumes that actors in the economy are responsive to money values, but unaware of what is taking place in real terms.

In the “banana republics”, this is not the case, so that flexible exchange rates lead to a perpetual chase between inflation and depreciation, with most participants in the drama hedged against any cut in real income by one or another protective device which is triggered off when the exchange rate falls. On this account, Johnson recommends fixed exchange rate and a loss of autonomy for these countries. France succeeds in a devaluation, however, only as President DeGaulle (as in 1958) or President Pompidou (as he hopes in 1969 and 1970) succeeds in enforcing a cut in real wages. The British cannot improve their balance of payments unless they do likewise.

Most economists hesitate to put reliance on money illusion but are ready, even eager, to embrace exchange illusion. In the modern world where the citizens of large countries are as intelligent as those of banana republics, this is unwise. The flexible exchange rate does not operate on the real forces in the system. It is sometimes argued that it provides a cover under which changes in real values can be brought about which cannot be handled under fixed rates. This is the moot but unresolvable question as to whether fixed or floating rates instill more discipline in central bankers and trade unions. But where is the autonomy?

The Case Against Flexible Exchange Rates

The main case against flexible exchange rates is that they break up the world market. There is no one money which serves as a medium of exchange, unit of account, store of value, and standard of deferred payment. Imagine trying to conduct interstate trade in the United States if there were 50 different state monies, no one of which was dominant. This is akin to a system of barter, the inefficiency of which is explained time and again by textbooks. Under a system of

freely fluctuating exchange rates, the world market for goods and capital would be divided. Resource allocation would be vastly suboptimal. In fact, such a system clearly would not last long.

What would happen in such circumstance is what happens in every case where there is no money: a money evolves. In prisoner-of-war camps, such money evolved from cigarettes. In the United States, there seems little doubt that New York money would take over. Each state would reckon its money in terms of New York units. New York money would become the intervention or vehicle currency in which all states reckoned, calculated cross rates, and undertook transactions. Montana would pay for imports from Texas initially by converting Montana units into New York money which would be exchange for Texas money. After a time, it would probably pay New York units directly to Texas and have them accepted directly. New York units would become the numeraire in which other currencies were quoted. The price of any other state currency would be expressed in terms of the New York unit, but the price of the New York unit would be impossible to express, since it would be the reciprocal of the price of all other units, appropriately weighted, which is the way "money" is priced.

This is the system followed by the world, with sterling serving as the numeraire prior to 1913, and the dollar from 1919 to 1933 and again after 1934. Individual countries could add to their sterling or dollar holdings by developing an export surplus or borrowing. Leaving aside gold production, which is basically irrelevant, world money outside the leading financial center could be increased only as the center had an import surplus or loaned abroad beyond its export surplus. If such borrowing went so far as to tighten interest rates, say in New York, and after the link to gold had been loosened, dollar creation offset it. In this way, dollar creation regulated the money supply of the world through the modality of the United States balance of payments on current account and foreign lending.

Under any system of flexible exchange rates, the drive to establish an international money is virtually inevitable. Even if central banks could be persuaded to give up the practice of intervening in the foreign exchanges — which I doubt — individual traders among those brave enough to continue in business under the uncertainty would hold foreign exchange from time to time to limit risks, and would almost certainly converge on a single currency to hold as a vehicle currency or numeraire. Under present circumstances it would be the dollar. Gradually with time the traders would exert pressure on their

governments to maintain the stability of their foreign holdings in terms of domestic currency. The stable exchange rate system, in my judgment, is inherent in the evolutionary processes by which barter moves to become efficient trading through use of a single money.

The process is not unopposed, not unbeset by other pressures. The natural tendency of the human species to want to have its cake and eat it too, frequently leads to loose monetary policies, especially in time of war or crisis. One hundred percent of the populace, including government, demanding shares of national income summing up to 110 percent or more of the total, each backing its demand with market or political power, produces structural inflation.

Professor Friedman believes that there is no such phenomenon as structural inflation, as he blames central bankers for yielding to the demands on them for more credit when wages are pushed up. This is one way to look at it, though not a very fruitful one. Sometimes central bank and treasury officials initiate inflationary spending or increases in money; at other times, which are worth differentiating from the first, they are helpless victims of irresistible political pressures elsewhere in the economy. If they were to try to resist, they would be replaced. The counsel of perfection which advises potential central bankers to refuse to take the job unless they are granted political independence to resist any and all forces pushing for expansion in the economy is intellectually interesting but not helpful.

In the "banana republics," to use Johnson's phrase, fixed exchange rates are desirable but impossible. The consequence is a race between internal inflation and external depreciation in which all but the weakest forces in the society learn to protect themselves, but money is unable to perform its functions as a store of value and standard of deferred payment. Contracts are written in commodities or foreign exchange; riches are stored in goods, luxury apartments, numbered accounts in Zug. Monetary conditions are pathological, and the choice between fixed and flexible exchange rates is not open.

Where there is monetary discipline, the issue is whether to let the local money supply be determined independently, and in line with local needs, habits, predilections, idiosyncracies, at the cost of some shrinkage of the efficiency of the world's capital and goods markets, and the functioning of the international corporation, or to work to try to reshape local money requirements in the light of the larger system. There is a public good/private good problem here. If the

Phillips curves of Britain and German differ sharply, with Britain having such a strong need for full employment that it is willing to tolerate considerable inflation, and Germany so fearful of inflation that it is willing to tolerate substantial unemployment, particularly that of Mediterraneans, resolution is a serious problem.

It may be necessary after time — if these attitudes are unyielding — to adjust exchange rates. Admitted. In a rational world, however, it would seem unfortunate to break up the world market for goods and capital even temporarily — until a new basis of fixed rates could be evolved, because of such attitudes which should be capable of compromise and agreement on a worldwide rate of inflation. Making such an agreed rate stick in the short run creates serious problems. Again admitted. There is no escape from inflation control through exchange depreciation which only worsens it. Where national differences in trade-offs between full employment and inflation are held with paranoid intensity and cannot be compromised, there may be no choice but to break up the world market.

Rejoinders and Rebuttals

Friedman, Johnson, and especially Sohmen, all believe that the disintegration of the world market can be minimized, or, in Sohmen's view, eliminated by encouraging the development of forward markets. I do not want to go into this topic at great length partly because of the difficulty in its lucid exposition, and partly because I have been arguing the case with Professor Sohmen for about 10 years now without making any dent on his position (nor he on mine). Let me give one side of the case, however, which seems to me irrefutable.

The flexible-exchange-rate scholars suggest that a system of floating rates would not be particularly damaging to trade, capital movements, or the activities of international corporations because forward markets would grow up — covering risks for as far ahead as years — to allow all exchange risks to be hedged. With forward markets, uncertainty as to exchange rates would be eliminated. Hence flexible exchange rates would not be seriously adverse to world economic integration.

I find four holes in this argument. First, and a technical one, forward markets add nothing essential to the capacity for hedging which can also be undertaken by borrowing in one market and lending in the other, earning or paying the interest-rate differential. This assumes perfect capital markets, to be sure, but these are

virtually available to large international corporations. The convenience of forward markets for smaller firms, and the reduction in transactions costs — both of which may be granted — produce no change in the theoretical capacity to hedge exchange risks without forward markets.⁸

Second, hedging does not eliminate exchange risk. Under a system of flexible exchange rates, a trader faces two risks, one on the price he pays or receives for foreign exchange, the other the possibility that his competitors may get a more favorable rate. It is possible to hedge against the first risk, not against the second. Accordingly, forward markets or hedging through spot transactions by borrowing/lending does not remove all risk.

Third, as Anthony Lanyi states in a judicious treatment of the costs and benefits of flexible exchange rates, which, however, comes out in favor of flexibility, hedging is needed not for particular transactions, but for activities.⁹ Business will not undertake investment in exporting, importing, producing abroad, foreign-security underwriting, etc., secure only in the knowledge that it can hedge the foreign-exchange risk in individual transactions. It must have a sense of where comparative advantage lies over a longer period. Granted, there are risks of foreign-exchange controls under fixed rates. This is the *tu quoque* argument used by small boys (which makes it advantageous to attack first). The issue here is only whether a system of flexible exchange rates inhibits world integration, as Johnson asserts, or not.

Fourth, and the issue which Sohmen and I have the most difficulty in seeking to resolve, forward markets or spot markets with hedging through borrowing/lending cannot guarantee a businessman the existing exchange rate before he enters the market since his entry may produce a change in the rate. Johnson, for example, states (*op. cit.*, p. 20):

Under a flexible exchange rate system, where the spot rate is also free to move, arbitrage between spot and forward markets, as well as speculation, would ensure that the expectation of depreciation

⁸I made this argument to Paul Einzig, who countered that my view of the matter is static, as opposed to his which is dynamic (*A Dynamic Theory of Forward Exchange*, 2nd ed., London, Macmillan, 1967, p. xv). Apart from frictions which may reduce the capacity of forward markets to provide facilities for hedging, I am unable to see what a "dynamic theory" of forward exchange may mean.

⁹Anthony Lanyi, "The Case for Floating Exchange Rates Reconsidered," Princeton, *Essays in International Finance*, No. 72, (February 1969), p. 5.

was reflected in depreciation of the spot as well as the forward rate, and hence tend to keep the cost of cover within reasonable bounds.

This is protecting a trader against a change in the rate by producing that change, the logic of which escapes me. Johnson and many like him have confused the spread between the spot and forward rates, which is equal to the interest differential, with the cost of hedging, which is the difference between the rate at which an individual calculates a deal will be profitable, and the rate he pays for his exchange. If his calculations were made on the basis of a given spot rate, and he is able to cover through the spot market with borrowing/lending, or through the forward market at the interest differential, his cost of cover is equal to the interest differential, plus or minus. But if the exchange rate moves because of his transaction — and those of like-minded people responding to the same phenomena — the interest-differential fails to measure his cost. He is able to hedge only by moving the rate to such an extent that a change occurs in the current account — imports being cut off by depreciation, for example, or exports stimulated, or by a capital movement — in the present instance a speculative capital inflow.

Any unbalanced movement in trade or one-way movement of capital will change the rate, regardless of the existence of battalions of forward-exchange traders and arbitrageurs, and must change it sufficiently to induce an opposite movement in trade or capital. If there are large amounts of capital eager to undertake stabilizing speculation, the rate will not move far. If not, it may have to move far. Arbitrage cannot accommodate a purchase of forward exchange without an effect on the spot rate. The two forward transactions may cancel out but the spot rate must move far enough to induce an opposite flow of funds, or surplus of current payments, to match the spot transactions of the arbitrageurs.

In Sohmen's system, the spot rate stays fairly steady, but changes in the forward rate induced by direct forward transactions or by the forward half of arbitrage transactions can be offset by trader contracts for future imports and exports, stretching forward perhaps for two or more years. But this requires forward markets for goods of equal length; if not, the traders have exchanged a speculative position in foreign exchange for one in commodities.

In short, forward exchange is one of those complex topics which is reassuring to the lazy analyst, at least on my showing. For all its

complexity, it changes nothing and can be ignored.

“Best” and “Best Available” Solutions

Let me turn from digging away at the opposition to something more positive, and start with the best and worst of international monetary systems. The first-best, in my judgment, is a world money with a world monetary authority. The authorities should be charged with regulating the world money supply so as to maintain its value stable, or perhaps declining very slightly each year to stimulate employment. This would be an economically integrated world, with a common set of prices and interest rates, adjusted in all cases for the total or partial separation of some markets for some goods, services, and kinds of investment money — including distance from major markets. The distribution of money and credit among regions or countries would respond to trade and capital flows unhindered by governmental obstacles. It is the system worked out in the United States, and sought — but not yet achieved — in the European Economic Community. It is probable that some redistributive mechanism is necessary to relieve those hardships which the market may inflict on certain regions and industries in this system, perhaps automatically through the tax system, with its different distributions of benefits and costs, perhaps in part through subsidies, subventions, foreign aid, and the like to marginal participants in the market process.

This is an economic first-best in my judgment. Most economists will agree that it is politically unattainable. When economists move from the first best to more feasible if less efficient solutions, however, note that they are undertaking implicit political theorizing in rejecting this or that solution as politically unworkable. There is no rigor, no science, no experimentation, some historical observation, and much intuition in these judgments. But economists cannot dodge the necessity for political theorizing since no one else is available to do it.

Almost identical with the first-best solution is the fixed-exchange-rate system with coordinated policies. According to a theorem of Hicks, two or more goods which have a fixed price can be regarded as a single good. By analogy, two monies which are freely convertible into one another at a fixed rate of exchange can be regarded as a single money. Regulation of the money supply so as to keep the monies freely convertible into one another at a fixed price requires

coordination of money creation and extinction, along the lines of the distribution of money under the system of a single money used throughout the world. The gold standard was regarded as such a system for coordinating and harmonizing policies in this fashion, with countries gaining gold through trade surpluses or capital inflows expanding their money supply in some appropriate multiple of the gain, while those which lost gold contracted in the same degree. The gold standard, or a system of credit money with fixed rates, assumes that prices, wages, interest rates, etc., throughout the system will be adjusted to one another, and to the world money supply, by economic forces and not to serve political ends.

Most economists insist that this system has been tried and found wanting, since separate countries do not order their monetary, fiscal, price, wage, etc., policies as called for by the system, but rather respond to local pressures, generally resisting deflation, accepting inflation, operating along Phillips curves, etc., at different rates, and in response to different historical experience and with different mental blocks, so as to make the system inoperable. Most of them focus on the different price experience of different countries, and with the aid of an explicit or implicit theory of purchasing-power parity, call for adjustment of exchange rates, usually on a continuous basis.

Economists, moreover, have little difficulty in agreeing on the worst system. Nth best in a system of 1st, 2nd, 3rd nth best, is fixed exchange rates maintained by interferences with movements of trade, capital, and persons (such as tourists). This system confuses the container with the thing contained. Some economists have no difficulty in accepting control over capital movements, so long as tourists and goods are free, on the ground that capital movements are not always dictated by efficiency considerations so much as capital flight from situations which people cannot escape, especially normal taxation.

If the best is unattainable and the worst must be avoided, what is second-best and still feasible? In particular, how much economic efficiency should be traded off against alleged political feasibility in a world where hard political data or even firm opinions on the behavior of political figures in relation to monetary phenomena are impossible to obtain?

Take such an issue as centralization. Most of us amateur, implicit, political theorizers agree that decentralization and local participation

are good, but that for some problems, such as regulation of the money supply, central control is inescapable. In the world monetary system, national sovereignty makes operation of an international credit standard impossible, or does it? I have recently read a plea for raising the price of gold by a distinguished economist who bases his argument on the explicit political ground that while gold was wasteful compared to credit money (an economic argument), it was useful (politically) in making the money supply of individual countries independent of the actions of other countries. This strikes me as both wrong and misguided: wrong because the deep-seated forces of the world will be searching for a single convenient money as a medium of exchange, unit of account etc., under any monetary system, whether flexible exchange rate or based on national monetary policies relying on national gold reserves; misguided because an economist has little business making sweeping economic pronouncements based on political judgments. The shoemaker should stick to his last. The economist who finds largely political rather than economic reasons for his recommendations has either run out of ideas to support his prejudices or is in the wrong business.

Options and Choices

If we rule out a world currency with a world money supply established internationally, and a fixed-exchange rate system in which each country has responsibility for establishing its money supply in accordance with agreed rules, such as under the gold-standard "game," the choice of a real second-best comes down in the minds of most economists to a national currency standard, or to flexible exchange rates. Of late, freely flexible exchange rates have been abandoned in favor of either a wide band, i.e., rate fluctuation constrained within fairly wide limits; or a crawling, sliding, creeping peg.

Each of these recognizes that speculation may drive the rate way up or way down and impose burdens on domestic policy, and possibly irreversible movements in prices and wages which should be avoided. The sliding peg, much better than the band proposal, recognizes that there are likely to be many occasions when short-run exchange movements should be constrained but not the long run (the band constrains long-run movements but not short). The question for investigation is whether it is second-best to relax the discipline of a fixed-exchange-rate system and give up the attempt to

harmonize national macro-economic policies into a converging world position, at some cost in efficient resource allocation, or to undertake the harder political task for higher economic reward.

There is a choice which Despres, Salant and I have long advocated, and to which Professor Friedman has come around. Professor Friedman regards it as a variant of the flexible-exchange-rate system; in my judgment, it belongs in the fixed-rate stable. I refer to the standard referred to by Professor Edmund Phelps in a recent conference as "How to Stop Worrying and Get to Love the Dollar." It requires the United States to stop worrying about its balance of payments (other than the current account, which is currently in a poor position) and to remove its restrictions on capital movements. Other countries can adopt whatever exchange rate they choose. Professor Friedman would recommend that Britain, Germany, and France follow policies of freely floating rates. I would leave it up to them but, as a betting man, be prepared to make a small wager that they would continue, as in the past, to keep their currencies fixed in terms of dollars, even after the withdrawal of such inducements as the German-United States military offset agreement. If I proved to be wrong in the short run, moreover, I would be prepared to bet that in the long run the convenience of maintaining reserves in the dollar, the world's numeraire, a money's money, would be so compelling that they would again stabilize.

To achieve the integration I seek and to limit risks, it would be advisable for countries to indicate to the world whether or not they intend to stabilize their currencies. With those which did so seek, I have recommended elsewhere that the United States seek to work out common monetary policies, so as to defuse the dollar standard from the political dynamite of an imposed dollar standard. The details lie outside the scope of this paper.

In short, I regard as 3rd best, with a chance of its achievement, a dollar standard managed internationally since I judge unattainable the first-best world money and world central bank; and the second-best fixed-exchange-rate system with independently-operated national monies. Fourth best is the crawling peg. The flexible exchange rate system is well down the list.

DISCUSSION

MILTON FRIEDMAN

I should say in advance that I have one great advantage over you people. I had a text of Charlie's paper beforehand and, since he only read part of it, I have a larger collection of fallacies from which to choose than you do.

I may say at the outset that I am amused by two general points. Charlie stressed that the case for fixed exchange rates is the same as the case for a money's money. As he said that, I started listing in my mind the names of people who are for fixed rates and those who are for flexible rates, and also the names of people who have put great emphasis on the importance of money. As I think most of you will agree if you think of those names, there is almost a one-to-one correspondence. The economists who have put most emphasis on the importance of money are flexible exchange rate people. The economists who have favored fixed rates have put least weight on the role of money. So it should give us a little pause whether it can really be so obvious that the case for fixed rates is the case for money.

The second general point is that never in my wildest dreams did I think that I was going to be subject to attack on the grounds that I gave undue weight to political feasibility in making policy recommendations.

One other introductory comment. I want to warn you that there is a real problem of avoiding cases of mistaken identity in reading or listening to Charlie's paper. He refers to somebody by the name of Friedman in the paper — but there are two Friedmans in his paper. I recognize one of them. The other fellow I've never met; I don't know who he is, so I don't know where Charlie got the idea he had the ideas he attributed to him. A second case of mistaken identity is that there are also two Johnsons. There is one Johnson from whom there are quotations, and I recognize the quotations. They are from my colleague Harry Johnson whom I know very well. There are other ideas, that I know my colleague Harry Johnson does not have, that are also attributed to a Johnson. So that must be still another Johnson. To add to the difficulties, there are two Kindlebergers. Statements made in one part of this paper by the author whose name is Kindleberger are inconsistent with statements made in other parts of the paper. So somehow Charlie and his twin brother must have

drafted different parts of this paper. Let me start with this final point because it helps to illustrate some of the others.

A System of Universal Flexible Rates versus Some Flexible Rates

At the beginning of his paper — and this is a sentence which he read — he said, “Johnson’s paper fails to make a distinction between a universal flexible exchange rate system and the adoption of flexible exchange rates by one or more individual countries in a world where at least one major currency is fixed or passive”. Let me spell that out a bit. Let’s take the case where one major — not *at least*, but *exactly* one — major currency is fixed. Then Charlie says that there is a distinction between a world of universal flexible rates and a world where every country but one has flexible rates. That is the statement on page two to three of his duplicated text. Later on, on page six, Charlie says — and this is a sentence that he did not read — “This is the well-known N-1 problem which makes it evident that a system of N flexible exchange rates for N countries is over-determined.” Now that statement is correct. If there are N countries, there are N-1 independent rates. The first distinction that I read simply doesn’t exist. A universal flexible exchange rate system is the same as and not different from a system in which one exchange rate is fixed. If I have two currencies, A and B, I don’t have two different exchange rates. It is not possible for both A/B and B/A to go up. If A/B goes up, B/A goes down, and one Kindleberger recognizes that in the second statement that I quoted. It is a good thing that Johnson didn’t make the distinction that the other Kindleberger criticizes him for not making because it’s not a valid distinction.

The other Kindleberger goes on to say, “Nor was this distinction originally made by Milton Friedman in his famous *Essay in Positive Economics*, an omission which, as Professor Friedman now magnanimously concedes, has been productive of much confusion”. Kindleberger attaches a footnote to this sentence referring to a brief paper of mine in the latest *Proceedings* volume of the *American Economic Association*. Let me read to you what I actually said, and see if you can find any relationship between that statement and the statement Charlie attributes to me. What I said was, “The discussion of these issues has been confused on both sides — and I plead guilty to contributing to this confusion — by failure to keep sharply separate the options that are available to a single country and those that are available to the international community”. That is a very different

distinction than the one Charlie attributes to me. I go on to say, "The critics are right that the U.S. cannot on its own float the dollar in the fullest sense of that term. Hence, I no longer describe my policy recommendation for the U.S. in those terms." Charlie says I have two different positions — before and after. That isn't what these words say. What they say is that I now think that my earlier description of my one policy position was not a good description. It was a description that led to some confusion, because I talked about what was desirable for all countries together, and I did not separate out what a single country could do.

I now believe that it reduces the confusion to separate sharply what one country can do from what all countries can do. But the system that I favor now is identically the same as the system I favored at an earlier date. I went on in my AEA comment to say that what the U.S. alone can do, and what I continue to believe it should do, is to set the dollar free by ceasing to peg the dollar. It can leave it up to other countries whether the dollar floats or whether they link their currencies to the dollar. That is one example of the two different Friedmans that you have to keep separate in Charlie's exposition.

World Integration

As to Professor Johnson — the two different Johnsons — there is one Johnson who is quoted on the first page of Charlie's paper and Charlie read this in his verbal statement: "The case for fixed rates," says Professor Johnson, "is part of a more general argument for national economic policy conducive to international economic integration." Johnson never said that was a valid case. He said those who make the case make it in these terms, and that is true; those are the terms in which they make it. Says the other Kindleberger about Mr. Johnson, and this sentence he did not read: "A system of flexible exchange rates inhibits world integration as Johnson asserts." I challenge Charlie to find a sentence in which Johnson asserts that a system of flexible exchange rates inhibits world integration. There certainly are circumstances under which fixed rates might promote world integration, but there are other circumstances under which fixed rates might reduce world integration. It isn't a simple matter — fixed rates, integration; flexible rates, disintegration. It depends critically on what the other circumstances are. It is perfectly possible for a man to say that those who argue for

fixed rates are doing so in the desire to attain world integration. I believe that many fixed rate advocates have world integration as an objective. So do I. I, therefore, approve of their objective. But I say, and Harry Johnson says, they are reaching a wrong conclusion if they believe that the best way to promote that desirable objective today is by a system of fixed rates of the kind that you are likely in fact to have.

But let me turn to more significant matters than cases of mistaken identity. In connection with much of Charlie's argument, I was reminded of the old story about the man who saw a friend of his looking on the ground under a light. He asked him what he was doing. His friend said he was looking for some keys that he had lost. Asked the man, "Did you lose them here?" "No," said his friend, "I lost them up there." "Why are you looking here?" "This is where the light is." Charlie provides all the good arguments for one system which is where the light is: a system of unified world money. That would be a good system, that I would favor. He then implies that the arguments that are valid for a unified world money also hold for a completely different system — a system of national currencies linked by fixed exchange rates. In my opinion, the most important single confusion in the whole discussion of exchange rates is precisely this confusion between a unified currency on the one hand — what we have in the U.S. among the different states — and a collection of national currencies with separate national monetary authorities linked by pegged exchange rates — what we have under what is called the fixed rate system but is in fact an adjustable peg system. Let me turn more specifically to Professor Kindleberger's arguments.

Causes of Disequilibrium in a Country's Balance of Payments

I have already pointed out his confusion between two distinctions: what one country can do versus what all countries can do, and a system of universal flexible rates versus some flexible rates. Let me turn to the logical validity of some of his other statements. Says Professor Kindleberger, "Disequilibrium in the balance of payments of an ordinary country is the result of one or more of the following things: excess spending, excess money creation, too low a rate of interest, too high prices, too high wages, distrust of the currency."

In the first place, most of those terms are undefined and undefinable. What is too high prices? Too high relative to what? Implicitly, Kindleberger has a proper exchange rate in the back of his

mind. Too high wages, relative to what? Secondly, and more important, even if we could define each of these terms precisely, a disequilibrium in the balance of payments of an ordinary country need not reflect a single one of these things. Consider a country that is engaging in none of these things; it has no excess spending, it has no excess money creation, it does not have too low a rate of interest, it does not have too high prices, it does not have too high wages, and there is no distrust of currency. But other countries engage in inflationary or deflationary monetary policies. If our hypothetical paragon of a country held the exchange rate fixed, it would clearly have a balance-of-payments problem that doesn't derive from any of the things listed by Kindleberger. So his assertion is a fallacy.

Solutions

Next Kindleberger says, "The first-best policy is to correct the cause of disequilibrium." Nonsense. For our paragon of a country, doing what it can do, the first-best policy is to adjust its exchange rate. It has the right wages and the right prices in terms of its own currency; it has the right relative wages and the right relative prices under the former conditions of demand and supply of foreign exchange. The first-best answer on its part is to adjust the exchange rate to offset the inflationary or deflationary policies of other countries so that it can go on in proper equilibrium without having to engage in completely unnecessary internal adjustment. This particular example is also a counter-example that proves the fallacy of Charlie's next statement. He said, "Exchange depreciation eliminates a deficit in the balance of payments only as it works to produce a change in the real value of one or more of the parameters, i.e., as it works to cut the real value of money wages spent."

In the example I just cited, the paragon of a country that was in initial equilibrium had everything right. It was not necessary for the country to change the real value of money wages or spending or anything else when the other countries inflated or deflated. It simply had to change the exchange rate in order to prevent undesirable changes in the real value of money wages. So Professor Kindleberger's assertion is simply false.

As a final example of a logical fallacy, Kindleberger says, "it assumes" — that is, the proposition that exchange depreciation eliminates a deficit in the balance of payments — "that actors in the economy are responsive to money values but unaware of what is

taking place in real terms.” That is wrong. For exchange rate changes to produce equilibrium does not require any form of money illusion whatsoever. A system of equations can be expressed in terms of real magnitudes, including the rate of exchange between one country and another, including the real terms of trade, and so on. It does not require any money illusion on anybody’s part for such a system to be in equilibrium, as I just illustrated with my particular example of a paragon of a country.

The proposition that exchange depreciation eliminates a deficit in the balance of payments only insofar as there is money illusion is offered by Kindleberger as a logical proposition in economic theory. But you cannot find it in any theoretical treatment of the problem of exchange rates or international trade because it is fallacious.

Let me turn to a different issue, skipping some of Charlie’s paper to conserve your time and your patience and give Charlie a chance to beat me back.

Less Exchange Risk under Fixed Exchange Rates?

Let me turn to what I regard as probably the most important single issue involved in the argument for and against flexible rates. It is the issue brought up by Charlie when he asserted that the essential case for fixed exchange rates and against flexible exchange rates is that there is less exchange risk under fixed exchange rates than there is under flexible rates. That is, he said, the essential argument. It’s the argument to which he devoted all of his discussion about various forms of forward hedging. It is the argument that Sir Maurice Parsons presented this morning in talking about the problem of capital flows.

In respect of this argument, I feel as if this is one of those continuous movies, and that this is where I came in 20 years ago. In 1950, when I wrote the article that Charlie refers to, “The Case for Flexible Exchange Rates,” I took seriously the argument that there might be destabilizing speculation — that is really what Kindleberger’s and Sir Maurice’s arguments come down to. It is now 20 years later. There has been an enormous amount of empirical work done on this issue. In a debate a couple of years ago with Bob Roosa, I challenged him — and now I challenge Professor Kindleberger and I challenge Sir Maurice Parsons — to provide not assertion, not fears but some empirical evidence that shows that such consequences do flow from flexible rates.* Destabilizing speculation is a theoretical

*See Milton Friedman and Robert V. Roosa, *The Balance of Payments: Free Versus Fixed Exchange Rates*, (Washington, D. C.: American Enterprise Institute, 1967), esp. pp. 105-107.

possibility, but I know of no empirical evidence that it has occurred even as a special case, let alone as a general rule.

How can this be? Isn't it obvious that fixed rates remove risk and flexible rates increase exchange risk? Not at all. The amount of uncertainty that there is to be met is unchanged. The difference between the two systems is the form that the uncertainty takes. Under a fixed rate system, the uncertainty takes the form of whether there will be major exchange rate changes every 5 or 10 years; it takes the form of whether there will be exchange controls; of whether there will be restrictions on imports and exports; of whether you will be able to get your money out. It does me little good to know that if I can get my capital out, it will be at a fixed rate, if I also know that I am likely not to be permitted to get it out just when that fixed rate would be most advantageous. So the fact is that under fixed rates there are exchange uncertainties.

What do these exchange uncertainties arise from? They arise from variations in the real forces affecting international trade that are sometimes favorable, sometimes unfavorable to a country. They arise from the adoption of different monetary policies by different countries; the adoption of different fiscal policies; elections; earthquakes — all these sources of uncertainty are present, whether you have fixed or flexible rates. The difference is that if you have flexible rates, the uncertainty manifests itself in changes in the price of exchange. It manifests itself promptly but gradually, in a way to which people can adjust promptly. When you have fixed rates, the uncertainty manifests itself in exchange and trade controls, in restrictions on what you can do, in large discontinuous changes in exchange rates from time to time.

One manifestation of uncertainty may well be more disturbing to international trade than the other. If you ask yourself which you would expect to be more disturbing, I think all of our experience suggests that the manifestation under fixed rates would be expected to be more disturbing than the manifestation under flexible rates. Why? Because we have observed over and over again that governmental intervention to peg a price, whether it be of wheat, or housing space, or any other good, produces much more serious problems of adjustment than fluctuations in prices. Businessmen all over the world have been able to cope with widely changing prices far more readily than with governmentally fixed prices on railroads, let alone with governmentally fixed exchange rates. So you would expect that uncertainty would be less disturbing to business, to

capital movements and to trade movements under flexible than under fixed exchange rates.

If we look at the empirical evidence, and I think I have looked at all the studies that have been published, I do not know of a single documented case in which flexible rates have in fact been accompanied by destabilizing speculation. I sometimes feel like giving the standard reply in poker to a man who is hesitating whether to meet a raise: "Put up or shut up." It seems to me it is about time for those people who argue that uncertainty is less disruptive to trade and capital movements under fixed rates than under flexible rates to give us some evidence or else to stop making the assertion that it is.

Hedging Long-term Capital Movements

One further point on this issue. The persistence of capital movements and trade movements with flexible rates does not, in my opinion, depend very critically on the existence of sensitive and far-flung forward markets. I may not agree with Charlie's long disquisition on forward markets, but I do not regard the problem it raises as very serious. Even if I accepted every word he said, it wouldn't bother me, because that isn't the way long-term capital movements are hedged anyway. The fundamental hedging in long-term capital movements between countries, as within a country, comes from the fact that the investment is made in real terms not nominal terms. If I invest for 20 years from now in a British industry, and if the British exchange rate depreciates to 1/10 of its present value in terms of dollars over the next 20 years, the odds are enormous that the reason will be because British prices in sterling have risen over that period by a corresponding amount relative to U.S. prices in dollars. As a result, the exchange rate will be less favorable but I will have a larger amount of pounds to convert into dollars. That is the fundamental hedge in all long-term capital investment whether between countries or within a country. And you do not need any further forward market for long-term hedging. As a result, I conclude that there is every reason to believe that in the world as it now exists, and as it is likely to exist, a fixed rate system will be more disruptive to capital movements and to trade than a flexible rate system.

The Best International Monetary System

I come to Page 16 of Charlie's paper and to a sentence that he read

that I want to comment on. He says that he is going to talk about the best and the worst in the international monetary system. He says, "The first best in my judgment is a world money with a world monetary authority." Now, I will agree with that sentence if he will let me add three letters. I want to make it read, "The first best in my judgment is a world money *without* a world monetary authority." Now *that* is the fundamental issue.

A unified currency is a currency among political units that do not have separate monetary authorities. Given that you have a world with separate national governments, I cannot believe that anyone who thinks this issue through carefully — on a political as well as economic level — will be in favor of a real world monetary authority. To anybody who has the impression that he is in favor of a real world monetary authority, I recommend very highly *Souvenirs d'un Gouverneur de la Banque de France* by Emile Moreau, edited by Jacques Rueff, and published about 15 years ago (Paris: Génin, 1954), telling about the attempted cooperation from about 1925 to 1928 or 1929 among the great central banks of Britain, of France, of Germany and of the United States. That book, I may say, was the final clincher in persuading me that I was opposed to a world monetary authority.*

A world monetary authority is a politically irresponsible authority which does not have a representative relation to the people of the world. At best, it is a benevolent dictatorship of "experts" chosen in an arbitrary way and subject only very indirectly if at all to any effective political process. A world money with a world authority is, I believe, the worst best and not the first best on both political and economic grounds. On the other hand, a unified world money without a monetary authority would be a pretty good system. I have no objection to that. If people everywhere want to use gold or peanuts or anything else as money, that is not a bad system. That is not a system that can be manipulated or that will have many of the defects I have talked about.

How to Change Exchange Rates

In fact, Charlie recognizes that what he is talking about is not a unified world monetary system, with or without a world monetary authority, but a system in which exchange rate changes occur

*See my article, "Should There be an Independent Monetary Authority?", reprinted in my *Dollars and Deficits* (Englewood Cliffs, N.J.: Prentice-Hall, 1968), pp. 173-194.

discontinuously from time to time. He states the issue on Page 18, in the usual, "When did you last beat your wife?" form. He says, "How much economic efficiency should be traded off against alleged political feasibility in a world where hard political data or even firm opinions on the behavior of political figures in relation to monetary phenomena is impossible to obtain?" I believe that that states the issue incorrectly. The issue is not whether you are for or against economic integration or for or against economic efficiency. The fundamental issue, as I have tried to stress again and again, is how to have exchange rate alterations. Is the most effective way to peg a rate, go through all sorts of contortions and manipulations to try to maintain it, and then finally change it by a large amount in the disruptive fashion we have observed? Or is better to let rates be free to move, to let individuals separately make whatever arrangements and deals they wish with other individuals? I believe that the latter gives you a much greater chance to reduce barriers to trade. In my opinion, one of the major arguments for a flexible exchange rate system — and here I come back to one of the earlier points that Charlie made that I have dealt with implicitly but not explicitly — is that it makes the case for free trade clear and simple. If you have a flexible rate and you reduce tariffs, movements in the exchange rate will automatically protect you against having any adverse balance of payments effects, and therefore you are not exporting or importing unemployment.

Professor Kindleberger says, "The gain in autonomy for monetary and fiscal policy is an illusion. Along with one more variable there is one more target, the exchange rate." This is another of the logical fallacies in this paper. If you have a pegged exchange rate, keeping that exchange rate pegged is a target and you don't have the exchange rate as a variable. But if you say you don't care what the exchange rate is going to be then it does truly become a variable and you are not adding any targets. On the contrary. Under the fixed exchange rate system, you have to use the price level, or employment, or exchange control, or restrictions on imports or exports or fiscal policy — some one or other of your instruments — to achieve the target exchange rate. But if you let the exchange rate go free, you add a variable without a target, provided you are willing to let the exchange rate settle where it will. It is because you have this additional degree of freedom that you do get a greater degree of autonomy in internal policy, and, in particular, you can use it to reduce or eliminate restrictions on international trade.

I want to end by quoting from myself in order to give you the

other side of the statement Charlie made at the end, saying that I have come around to a choice that he has long advocated. Well, there is a difference of opinion about who has come where. Let me just quote from some testimony I gave to Congress about seven years ago. "In the meantime we adopt [in order to maintain our fixed exchange rate system] one expedient after another, borrowing here, making swap arrangements there, changing the forms of loans to make the figures look good. Entirely aside from the ineffectiveness of most of these measures, they are politically degrading and demeaning. We are a great and wealthy nation. We should be directing our own course, setting an example to the world, living up to our destiny. Instead we send our officials hat in hand to make the rounds of foreign governments and central banks; we put foreign central banks in a position . . . to exert great influence on our policies; we are driven to negotiating with Honk Kong and with Japan [as you see, seven years haven't changed that one] and for all I know, Monaco, to get them to limit voluntarily their exports. Is this posture suitable for the leader of the free world?" In a more recent Newsweek piece (January 29, 1969), in which I quoted this paragraph, I went on to say, "We should say instead to the people of the world: a dollar is a dollar. You may borrow dollars in the U.S. or abroad from anyone who is willing to lend. You may lend dollars in the U.S. or abroad to anyone who is willing to borrow. You may buy dollars from or sell dollars to anyone you wish at any price that is mutually agreeable. The U.S. Government will not interfere in any way. On the contrary, it will dismantle immediately its present restrictions: repeal the interest-equalization tax; dissolve the cartel agreement among banks to restrict foreign lending; remove quotas 'voluntary' or otherwise on imports; stop resorting to World War I emergency legislation to threaten with prison terms businessmen who invest abroad; refrain from interfering with the right of its citizens to travel when and where they will.

"If a foreign country wishes to peg the price of its currency in terms of dollars, we should not interfere."

That is the point that I emphasize and it involves a valid distinction between what one country can do alone and what a group of countries can do. I would urge other countries that they too would benefit if they would let their exchange rates go free. And if they did that, we would really be on our way to world integration because that is the only route that anybody has so far suggested that will enable us to make a start on dismantling our host of barriers to the movement of men, of goods and of capital.