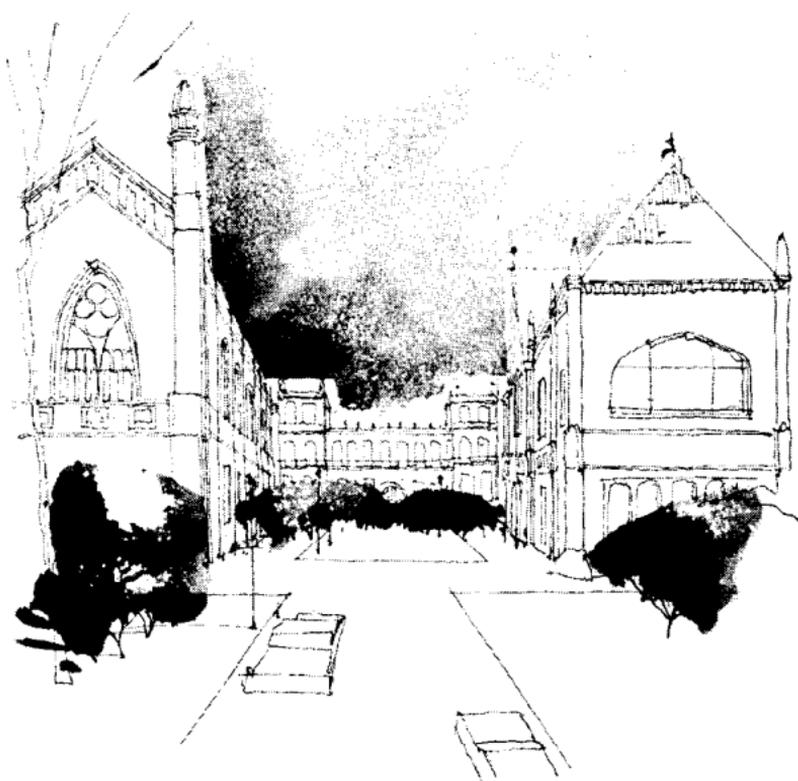


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The Long View and the Short

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The Long View and the Short

AT THE OUTSET I must confess that I have unabashedly borrowed the title of my talk from the work of Jacob Viner. Viner was for 30 years (from 1916 to 1946) a member of the faculty of The University of Chicago. He was a distinguished economist, a former editor of *The Journal of Political Economy* (which is published by the Department of Economics and The University of Chicago Press), and a staunch supporter of the School of Business.

In 1940, when Viner was President of the American Economic Association, he delivered the customary presidential address to his professional colleagues. The title of that address was "The Short View and the Long in Economic Policy." A collection of his writings was subsequently published under the title *The Long View and the Short*—the title I have borrowed for this talk.

In his presidential address Viner stressed the limitations of economists as advisers in the policy-making process, but he argued that economists have one marked advantage over non-economists: they tend to take the long-run point of view. They tend to look at the whole economy and to analyze how things will work out ultimately after various adjustments and readjustments have taken place. They tend to be skeptical of "instant" and "patchwork" solutions to complex and deep-seated problems, and they tend to look for efficient rather than expedient means for achieving desired ends.

"Legislators and officials," as Viner points out, "are typically busy and harried men . . . there is constant preoccupation with the problems that are immediately pressing, and little

stimulus to take thought as to whether preferred solutions are likely to prove lasting ones. There is especially little urge," Viner continues, "to go hunting for problems which are not yet felt as such but which may prove troublesome in the distant future."

I am not suggesting that all politicians are shortsighted and all economists are farsighted. Myopia is a common affliction. But it is my thesis that our international payments deficit, which has persisted for over a decade, has produced a series of short-run, shortsighted responses which predictably could not succeed in correcting anything and which have hurt our efficiency and discommoded our lives. Our international monetary arrangements are in a mess, if not a crisis, because we, as a nation, have persistently taken a short view and have tried to live within an international monetary system which in the long run is unworkable-unworkable unless we espouse controls and crises as a normal mode of life.

What is the nature of our difficulties? International economic relationships are complicated, but not mysterious. The source of our difficulties lies in the world payments system we helped to engineer during and after World War II. We helped formulate the Bretton Woods Agreements which established the International Monetary Fund, a gold reserve standard, and a system of fixed exchange rates at which foreign currencies trade.

Gold and the Dollar

The elements of the system are quite simple. The dollar is defined as 1/35 of an ounce of gold, i.e., the U.S. agrees to buy and sell gold to other countries at \$35 an ounce. Other countries define their currencies as fixed amounts of gold or dollars. This establishes a network of fixed exchange rates at which the goods, currency, and other assets of one country trade with those of others. If you

want to buy French perfume, the U.S. price depends on two things: the domestic price in francs of the perfume in France and the exchange rate at which you can acquire francs—currently five francs for each dollar. (Given the current difficulties of M. de Gaulle, it is not possible to predict how long this rate will persist.) The dollar price of perfume can go up either (a) if the French internal prices go up or (b) if the cost of acquiring francs goes up—that is to say if the franc appreciates and the dollar depreciates. Conversely, the dollar price of French perfume would fall if French prices go down or the dollar cost of francs declines.

With the present state of affairs don't expect cheaper French perfume. What is likely is that internal prices in France will rise and the franc will be devalued. Hence the dollar price of imports from France will stay at approximately present levels.

In a world of fixed exchange rates difficulties occur. Some currencies become overvalued and some undervalued. Some countries inflate their internal prices more rapidly than others. Changes in productivity, costs, and prices change the terms of trade among countries. And national states pursue uncoordinated internal domestic policies that affect these international trading and financial relationships. To oversimplify slightly, a country with an overvalued currency imports too much and exports too little. In other words, it has a deficit in its balance of payments. A country with an undervalued rate imports too little and exports too much, i.e., it has an international payments surplus.

Two-Price System

Now this is where gold comes in. Gold serves as international reserve money. The deficit countries lose gold to cover their deficits and surplus countries receive gold. Since dol-

lars are convertible into gold at a fixed price of \$35 an ounce, many countries use dollars rather than gold as their international reserves. In the gold crisis of last March the world took a step away from gold in setting up a two-price system for gold. Monetary gold is still traded among central banks at a fixed price of \$35 an ounce, and this monetary gold is segregated from the private market where the price is free to fluctuate.

But the gold problem, though related, is not really the dollar problem. Countries could, and will eventually, use some asset or collection of assets for international reserves—be they called SDR's, CRU's,¹ paper gold, or dollars. The crux of the dollar problem is the problem of fixed exchange rates.

Since 1958 we have had a chronic deficit in our international balance of payments and as a result have lost approximately \$10 billion in gold reserves. This loss in itself is not consequential because we came out of World War II with enormous gold reserves. But the fact that we had large reserves encouraged the short view and led us to delay taking steps of a more fundamental nature to develop a more viable international system.

The plain and indisputable fact is that the dollar has been and continues to be overvalued in terms of other currencies. I think it fair to say that almost all professional economists agree on this fact, whatever definitions are used.² As a result we import too much and export too little, and reserves pile up across the Atlantic.

Deficit and Surplus

For those of you who don't really under-

1 Special Drawing Rights and Composite Reserve Units.

2 See Harry G. Johnson, "An Overview of Price Levels Employment and the Balance of Payments," *Journal of Business*, XXXVI:279-289, 1963. Also Paul Samuelson, *Chicago Sun-Times*, March 19, 1968.

stand what a deficit or surplus is, let me digress briefly. As a nation we receive foreign currencies from several sources: the export of our goods and services, the export of financial assets (borrowing from foreigners), the expenditures of foreign tourists in the United States, repatriated earnings on previous investments abroad, and, of course, the export of gold. These sources constitute the inpayments, the deposits in our "international bank," as it were. We then proceed to spend these receipts on imports from abroad, services provided by foreigners, government expenditures abroad, travel by U.S. citizens abroad, purchases of foreign real and financial assets (these purchases are called capital exports). For simplicity you can always think of a capital export or outflow as an importation of foreign assets. Even direct foreign investment abroad is an indirect import; corporations buy foreign currencies to build plants abroad and import, in a sense, foreign labor, capital, and other resources thereby.

If our total outpayments (checks written against our international bank account) exceed our inpayments we have a deficit and we may have to sell more gold to cover our national overdrafts. When a currency is fundamentally overvalued, deficits persist and reserve losses are inevitable. Indeed, reserves will flow as inevitably as water downhill from countries with overvalued rates to countries with undervalued rates. And this is what the international liquidity problem is all about. If there is marked undervaluation and overvaluation within the network of exchange rates, large amounts of reserves are needed to keep the silly system afloat.

What can a nation do if it has a chronic international deficit? It can let its reserves (gold or gold and dollars) flow out until they are all gone, and the deficit country cannot beg or borrow more reserves from other coun-

tries or international financial institutions. And a crisis occurs. This is the difficult position in which Great Britain finds herself. What then? What can we do to avoid getting into similar difficulties?

Four Alternatives

There are only four courses of action open and some of these are not very promising.

One, we can try to control outpayments by restrictions on imports, travel, and the outflow of private capital. Unless these controls are comprehensive, they simply won't erase the deficit. And they violate our longer run goals of freer multilateral trade, they invite retaliation, they create serious economic waste, and they prevent normal economic adjustments from taking place.

Two, we can try to increase inpayments by subsidizing exports, selling assets, and repatriating earnings. Subsidies violate our treaty agreements, the American consumer, and principles of unfettered trade. They are also likely to be self-defeating because of retaliation.

Three, we can try to deflate our internal prices. Very tight monetary and fiscal policies for a sufficiently long period would deflate the economy and get our price level down. A lower price level would make our exports more attractive to others and lessen our demand for imports. This is the old gold standard formula. The gold-losing country is supposed to deflate and the gold-receiving country is supposed to inflate; opposite changes in their respective price levels would bring about equilibrium in international payments on both sides. A long period of depression or recession, and mass unemployment would be needed to deflate the price level enough to balance our international accounts. On average all the wages, prices, incomes, and con-

tracts would have to be broken down to a lower level. This method is, of course, completely unacceptable because it involves putting the economy through a wringer. To follow this course would be like advocating tuberculosis as a cure for obesity and would constitute gross mismanagement of our national affairs.

Four, we can devalue the dollar, i.e., change the rate at which the dollar can be converted into foreign currencies and vice versa. Given internal prices and costs, the exchange rate is the fulcrum across which flows of goods, services, and claims take place. Devaluation would raise the price of foreign goods here and lower the prices of United States exports abroad, and hence help to erase the deficit. But devaluation, too, is a “chancy game” because other countries can retaliate by devaluing with us. Moreover, the dollar is the major reserve and vehicle currency in international finance. Foreigners have acquired a large volume of dollars and dollar claims at existing rates. Devaluation would constitute a capital levy on foreign dollar holders. In short, devaluation requires an excruciatingly painful political decision which usually can be taken only in times of crisis.

What do our options add up to? The sad fact is all of them are immoral, illegal, or impolitic. So we have followed the British example of muddling through—a technique that consists of recognizing the facts and evading or concealing them. We have over the past ten years tried doses of all four cures with lamentable results. Indeed, we have progressively added controls to restrictions, disguised devaluation as exhortation, and protectionism as underemployment. We have embarked upon a series of short-run, “temporary” measures to meet a long-run problem and thereby imposed wholly unnecessary costs upon the economy—costs which in the aggregate are

now very large and bear upon us with increasing severity.

What We Have Done

Let us review some of the things we have done. We have tightened restrictions on imports through reduced tourist allowances, through "Buy American" regulations which effectively shut out many foreign suppliers to the U.S., through miscellaneous rules which require the use of U.S. services and facilities. We have progressively applied controls on U.S. investments abroad (those indirect imports I mentioned earlier). What started out as voluntary controls have become mandatory, and it is now a criminal offense (with a possible 10-year prison sentence) for corporate officers to violate them. We have put onerous and discriminatory restrictions on lending abroad by U.S. banks. And travel restrictions have been proposed.

It is both tragic and comic to note that in January 1962 President Kennedy could say in his Economic Report, "To place controls over the flow of American capital abroad would be contrary to our traditions and economic interests." Six years later, in January 1968 President Johnson could announce "We have already put into effect a new mandatory program to restrain direct investment abroad which will reduce outflows by at least \$1 billion from 1967."

We have subsidized exports in various ways, e.g., through Public Law 480 relating to the disposal of agricultural products and through unilateral restrictions that require aid dollars to be spent directly in the United States.

We have tried modest doses of deflation. The Federal Reserve system reacted to balance of payments pressures in 1959 and 1962 by reducing the money supply at a high cost in terms of unnecessary unemployment and fore-

gone real income output which could have been produced.

And we have devalued in ways intended to conceal the fact. The foreign issues tax (the so-called interest equalization tax) devalues the dollar for U.S. citizens and corporations that buy foreign securities. They must pay a higher rate for foreign exchange. We have devalued the aid dollar by requiring recipients to spend in the U.S. and compensating them in additional dollars for the higher prices in the U.S. given current parities of exchange.

The economic costs of defending the dollar at present parity have been substantial. The amount of time and effort needed to comply with the regulations, the interference with the allocation of investment capital around the world, the inefficient use of resources at home, the excessive costs of foreign aid and military procurement, excessive unemployment in the early 1960's: these in aggregate cannot be dismissed as inconsequential. To them must be added the erosion of freedom of persons and property and the strains added to our already strained political relations around the world.

Effects of Restriction

To echo the plaintive query of Roy Harrod, the distinguished economist, in Britain after World War II: Are these hardships really necessary? Most economists, including this one, would say they are both unnecessary and destructive. Professor Robert Mundell of our Economics Department argues convincingly against the President's program of restriction as follows:

"Whatever the initial effects on the foreign investment and travel accounts, the impact on the remainder of the total balance will be negative. This is because of (a) evasion of the restrictions through loopholes, (b) substitution of other forms of foreign assets affected by the

measures, (c) reduction in *the* inflow of foreign capital, (d) reduction in the trade balance surplus, (e) disguised capital exports through the under-invoicing of exports and the over-invoicing of imports, and (f) reduction of export supply because of the full-capacity state of the U.S. economy. All these effects can be predicted on the basis of economic theory and empirical studies of similar measures."³

The problem of the dollar, to revert to my theme, is the rigidity of the fixed exchange rate system, a system which is breaking down. The system does not even have the flexibility which its planners at Bretton Woods envisaged. Not only did the planners recognize that initial rates of exchange would be set arbitrarily, but also that they would have to be adjusted from time to time (the adjustable peg) to prevent persistent overvaluation or undervaluation of different currencies. The incentives of the system work against it. A deficit country will not devalue until driven to it by extremes of crisis and not until after it has created a lot of needless hardship in the interim. A surplus country will not revalue upward except under great world pressure because to do so would increase the prices of the things it sells and make the industrialists and farmers angry. A key currency country, e.g., the United States or Great Britain, cannot devalue without creating large financial losses for the foreign holders of key currency assets. That the system has worked as well as it has and survived as long as it has testifies to the power of theology over reality and the short view over the long.

Tax Increase

Where do we go from here? Most suggestions continue to be based on the short view. The Administration, central bankers, busi-

³ Reprint from *Congressional Record*, 90th Congress, Second Session, May 5, 1968, p. 26.

nessmen, and the press keep chanting the old cliché that we must get our fiscal house in order. Currently they insist that we must have a tax increase to prevent inflation at home. There are lots of good arguments on both sides of the tax increase. To the extent that it does help to prevent our internal prices from rising (and its effects are grossly exaggerated on this score) it will help to keep our balance of payments deficit from getting worse. But it cannot correct the deficit, and it would do nothing to solve the long-run difficulties of rigid exchanges. And besides, we don't need to use balance of payments excuses to want to prevent inflation at home.

Others have suggested we raise the price of gold. This would be another palliative. Raising the price of gold would increase the value of international gold reserves and buy time—reserves would last longer and flow out more slowly. It would probably help reduce our deficit as well, and in three ways. First, gold production would be more profitable and output of new gold would expand; some of the additional gold produced would be used to buy, directly and indirectly, U.S. exports. Second, with larger reserves, surplus countries might be less anxious to accumulate dollars and gold, and be willing to reduce restrictions on imports from the U.S. Third, some existing gold in Europe would come out of hoards at the higher price, thereby increasing bank reserves and the supplies of money. As a result European countries might inflate their price levels enough to make our exports more competitive and to reduce our imports. To pray secretly for inflation in Europe (as we have done for ten years) is one thing. To advocate and foment inflation in Europe in an attempt to validate an overvaluated and artificial exchange rate is quite another. This proposed course of action strikes me as cynical to say the least.

1 should also point out that devaluing the dollar in terms of gold, i.e., raising the price of gold, also does nothing to alleviate the constraints and rigidities of fixed exchange rates. Other countries would also revalue their gold upward. If everyone raised the gold price proportionately, the exchange rates would be precisely where they are now; \$2.40 to the 1 sterling, 4 German marks to the dollar, 50 Belgian francs to the dollar, etc. We might buy some time; we would benefit gold producers and gold hoarders; but we would not change the nature of the system or add new defenses against future crises.

Some people have proposed a further partial devaluation of the dollar in the guise of a temporary border tax on imports—a devaluation of the import dollar. Such a tax would be a further move to a multiple-rate dollar. In practice it would release powerful forces of protectionism in the United States which could not be turned off easily. Such a move would put the United States in a difficult moral position in trying to work toward a more liberal world trade environment. Of course, it would do nothing to put the international monetary system on a more rational basis.

Another group of proposals deal with the problem of international liquidity. Basically, these are plans to increase or improve international borrowing facilities for countries which find themselves short of reserves. To the extent that they move the world away from gold toward a better credit system they merit support. But facilities to create new reserves do nothing to correct under- and overvaluation of national currencies.

If most proposed solutions to our balance of payments problems appear inadequate or shortsighted, let me say the appearances are real. What is needed is a long-run workable mechanism of international payments and ad-

justments. And the long view provides the solution.

Float the Dollar

We could have a system of flexible exchange rates. In other words, we could cast off the gold anchor, float the dollar, and let the price of foreign currencies be determined in the open market. To do this we would discontinue U.S. Treasury purchases and sales of gold at a fixed price-in effect demonetize gold. Foreigners seeking to buy our goods and services would have to buy dollars at whatever price prevailed among foreign exchange dealers (banks) at any point in time. Conversely, U.S. citizens and corporations seeking to buy imports or other foreign assets would have to pay the same prevailing rate to acquire foreign currencies. The rate would fluctuate from day to day, depending on the forces of supply and demand, and would seek a level which would equilibrate the forces of supply and demand.

The advantages of a flexible rate are very real and obvious:⁴

1) A country with a floating rate could never have a disequilibrium—a deficit or surplus—in its balance of payments. If outpayments exceeded inpayments, the price of foreign currencies would rise, i.e., the local currency would fall in international value. If inpayments exceeded outpayments, the foreign currencies (and goods) would become cheaper and the local currency would rise in international value. Depreciation or appreciation would be automatic and open, and would not have to be concealed by exchange controls and other restrictive devices.

⁴ For an extended discussion of the relative merits and defects of flexible and fixed rates see the debate between Milton Friedman and Robert Roosa published in ***The Balance Of Payments: Free Versus Fixed Exchange Rates*** (Washington: American Enterprise Institute), 1967.

2) Not only would a floating rate produce prompt short-run payments adjustments, it would automatically set in motion the right kinds of longer run economic adjustments both at home and abroad. A falling rate would expand exports and depress imports. But these adjustments take time. Export markets have to be developed and foreign exporters must adjust to a reduced state of demand. Conversely, a rising rate would stimulate imports and depress exports, and the opposite adjustments would have to be made in the production and marketing of goods. With fixed rates, reserves move from one country to another, and the needed adjustments in resource allocation at home and abroad are long delayed. Since the purpose for foreign trade and investment is to secure a more efficient use of resources and greater world production, flexible rates have a decided advantage.

3) A floating rate would end (or reduce the strains of) the game of musical chairs played among nations with gold or other international reserves. Instead of shifting reserves around the world, or having them pile up over protracted periods in a group of surplus countries, the price system would work continuously and effectively to prevent surpluses and deficits.

4) Flexible rates would make it possible for countries to pursue independent domestic monetary and fiscal policies (which they are bound to do anyway) without artificial constraints and difficulties imposed by "balance of payments" considerations. Different countries obviously have different domestic priorities and goals-high employment, price level stability, etc. They will pursue and meet these goals with varying degrees of success. Under fixed rates undesirable repercussions are transmitted rather quickly from country to country-especially from the bigger to the smaller

(i.e., they export recession or inflation). Under flexible rates some repercussions would still be transmitted but on a much smaller scale. A country which inflated at a rapid rate would also have a falling rate of exchange, which would help sustain its export markets and prevent too large an influx of imports. A country which maintained a stable price level, with inflation proceeding elsewhere in the world, would have an appreciating currency. Each country would be free to pursue its own interests without being unneighborly.

Some Objections

But there are disadvantages of flexible rates, some real and some imaginary. Let me mention some of the objections raised by critics.

1) Flexible rates create foreign exchange risks for businesses which buy, sell, and invest abroad. It is assumed, therefore, that they would reduce international flows of goods and capital. That there would be exchange risks is certainly true, but the assumption that follows cannot be substantiated. First, the risks are greatly exaggerated. In well-functioning foreign exchange markets short-term positions and transactions can be covered and hedged. Second, a fixed-rate system cannot protect traders and investors against risks; the risks are simply of a different kind. The supposed advantages of fixed rates are elimination of exchange risk and the promotion of freer trade and investment. These supposed advantages disappear if new risks are created and the rates can be maintained only by controls and restrictions. Professor James Tobin of Yale, formerly on President Kennedy's Council of Economic Advisers, leans toward fixed rates; nevertheless he makes the appropriate comment about the risks under fixed rates:

. . . the prospect that countries will resort to these devices [restrictions on private transactions] in times of balance-of-payments stress

imposes on foreign commerce and foreign investment risks comparable to the risks of exchange depreciation. Once again we have, therefore, a clear danger of inverting ends and means. Exchange parities may be defended by means which subvert the whole purpose of defending them."⁵

2) Flexible rates will lead to economic isolation and bilateral agreements. The opposite, I believe, is true. The fixed-rate system is responsible for the restrictions, controls, disguised devaluation, multiple exchange rates, and bilateralism which now plague us. Previous experience with flexible rates has not been very helpful in settling the issue. The experience of the U.K. in the 1930's, for example, came at a time of world depression and after the collapse of the World Monetary System. In short, I think Professor James Meade of Cambridge University is right when he says: "We cannot preserve **both** a liberal cooperative system of international trade and of foreign aid **and also** fixed exchange rates between national currencies."⁶

3) A third argument is that we need fixed exchanges to enforce discipline in domestic monetary and fiscal policy. This view is espoused by **The Chicago Tribune** and a number of economic commentators. If it were not for the threat of international deficits and loss of reserves, they argue, the country would be too lax in taking monetary and fiscal steps to control inflation, and the pursuit of full employment would lead to a perpetual wage-price spiral. I do not agree. First, as I have already pointed out, we have strong domestic reasons, apart from the balance of payments problem, for wanting to curb persistent and substantial inflation. Second, perpetual infla-

⁵ James Tobin, *Hearings before the Joint Economic Committee, November 5, 1963.*

⁶ *Factors Affecting the U.S. Balance of Payments, Joint Economic Committee, 1962, p. 252.*

tion under flexible rates would bring a perpetually falling exchange rate (unless the rest of the world were also inflating at approximately the same rate or the world demands for the country's exports were growing at a rapid pace). Surely a falling exchange rate is as good an indicator as a reserve loss that domestic restraint be needed. And third, deficits and reserve losses may enforce a perverse discipline, calling for deflationary policies at the worst possible time when excessive unemployment exists at home. This sort of discipline, which we tried in 1959-60, we can well do without. In fairness to this position, however, it must be said the whole world might be somewhat more inflation-prone under a widespread system of flexible rates than under fixed rates.

4) Fourth, the argument goes, the world is not ready for flexible rates. Practical men of affairs-central bankers, bankers, businessmen, public officials-will not accept a flexible rate system. They fear the uncertainties that may be involved. That this is a real problem I do not deny. I have already observed that the short view is a powerful one. But because something desirable has some stubborn opposition is no reason to throw in the towel; any movement toward a more flexible system would be a move in the right direction.

5) Fifth, it is argued that a floating rate would be an unstable rate. Periodically, speculators would drive down a weak currency and make it weaker. No doubt there are situations in which foreign exchange speculation might be destabilizing-and the speculators would lose money. But surely in the normal course of events speculation would tend to even out short-run fluctuations in the rate, yet leaving it free to move over the longer run in response to changes in underlying economic conditions. A floating rate need not be an unstable rate, as Milton Friedman reminds us.

Indeed, given reasonable management of our internal domestic policies, the prospect is good for a stable dollar in its international financial uses.

What Might Happen

Let me speculate a little about what might happen if the United States decided to float the dollar. Obviously some currency blocs would form. The Common Market countries would want to keep rates fixed among themselves. The free-trade countries and possibly Great Britain might form another group with fixed rates. Many countries would want to fix their rates to the dollar because it is the strongest currency of generalized purchasing power, so a dollar bloc would form. This might not be a bad arrangement with rates fixed within blocs and flexible rates among them. At any rate (or rates), such an arrangement would be decidedly more flexible, more workable, and more conducive to international cooperation than the irrational system we now have.

The alarmists argue that if we float the dollar, other countries will impose restrictions and multiple rate structures upon us. Or they will tie their rates to the dollar anyway, and keep the existing fixed exchange rate network in force. I say "fine and dandy." If they peg to the dollar at undervalued rates, they will simply accumulate dollars till they overflow their central banks. What can they do with those dollars except spend them in the United States? And to do this they will have to appreciate their currencies in terms of the dollar (raise their peg) to encourage the import of U.S. goods. If European and other countries impose exchange controls, as is probable, they will hurt themselves more than us, and so be encouraged to remove them shortly.⁷ Besides,

⁷ See **Gottfried Haberler and Thomas Willit**, *Presidential Measures on Balance Of Payments Controls* (Washington: American Enterprise Institute), 1968, p. 39.

it seems likely that the volume and burden of the controls on world trade and investment would be smaller and less onerous than the controls we are now imposing on ourselves and the rest of the world. I would go further and point out that it is the central bankers, mainly those in Europe, who are wedded to the notion of fixed exchanges. If they want to live in such a world, let them take the responsibility for its difficulties and crises. With a floating dollar we could shift the responsibility to where it belongs. Under present arrangements the U.S. has to take the responsibility, the criticism, and the controls. It is time for a change.

Can Be Evolved

Let me be quite clear: I am not predicting precisely how a flexible rate system might evolve. I simply am saying that such a system can be evolved despite transitional problems and possible nationalistic responses to it. And it would be an improvement over the system we now have.

Let me conclude with an observation or two on the curious lack of support for flexible rates outside the academic community. It is clear that a large majority of academic economists favor flexible rates or a system with a good deal more flexibility than we now have. Yet this long view is not generally espoused in policy councils and by the press. The reasons are not hard to find. People in government simply cannot talk publicly about changing the system. To suggest either devaluation or a flexible rate would provoke a speculative run, and perhaps, crisis.

Central bankers and people at the IMF have a vested interest in the present system (even in the enlargement of the present system) and in their own importance. It is quite obvious that flexible rates, which obviate the need for moving or borrowing large amounts of reserves around the world, would greatly

reduce the role of central bankers and the IMF in the scheme of things. One should not expect, therefore, to get objective advice from these sources. Indeed, central bankers and the IMF should be the last source of advice on these matters. Commercial bankers, I should add, generally follow the lead of central bankers and treasury officials and repeat uncritically the party line.

Another more subtle reason why flexible exchanges may not get the political support they deserve is advanced privately by my colleague Arnold Harberger. He points out that if we had a fully flexible international exchange rate system it would be a more or less efficient market, in some respects like the stock market. Spot and forward exchange rates for each currency would be determined by the expectations of the world trading and financial community as to future rates of inflation in various countries. Political regimes would be exposed much more fully to the glare of world opinion as to the likely course of their domestic policies, and they would feel uncomfortable. If this surmise is correct, flexible rates would provide as much political discipline as do fixed rates. And it would also explain some of the political reluctance to explore the possibilities of flexible market rates more fully.

The press has largely ignored free or flexible rate proposals, and in doing so has, in my opinion, shirked its responsibilities. Processing press releases or reporting the press conferences of the Federal Reserve, the Treasury, the IMF, and visiting European central bankers with their carping and gratuitous advice will never contribute much to an enlightened public opinion.

So it devolves upon the academic economists, the impractical theorists, to continue to make the case vigorously, repeatedly, and patiently, for freely determined, or at least more

flexible, foreign exchange rates. Without the academic economist the long view will get short shrift.

In the long run, according to Keynes, we are all dead. I would remind you that in the long run that matters we shall also have to live with our mistakes. And in the long run all exchange rates are flexible. If we do not rely on the flexibility of the marketplace, we shall surely have to suffer the costly flexibility of import restrictions, exchange controls, disguised devaluations, travel restrictions and other unwarranted and unnecessary usurpations of our freedom.