exchange rates, with special attention to the consequences such a system would have if applied to the dollar. While this section is formulated in terms of arguments against flexible exchange rates for currencies of the major industrial countries, it argues in substance for an international payments system based on fixed exchange rates.

Review of arguments pro

The issue of an international payments mechanism with fluctuating exchange rates versus one with fixed exchange values has many ramifications, and any summary of arguments risks criticism as doing less than justice to the case made by those who advocate a generalized system of fluctuating exchange rates applicable to the currencies of both less developed and highly developed nations. At the risk of such criticism, the following points endeavor to summarize the principal contentions by advocates of such a system.

1. The exchange rate is the price for a foreign currency in terms of the domestic currency. In equating short-run supply and demand and in inducing equilibrating adaptations in basic supply and demand conditions over the longer run, the prices of foreign currencies should be as free as other prices to vary with shifting supply and demand forces.

2. Under modern systems of managed convertible currencies, governmental policies directed to the attainment of stable economic growth domestically may obstruct and frustrate the processes for bringing about balance in international payments that are postulated in gold standard theory. A system of floating exchange rates, however, could provide a mechanism of adjustment through market processes and would be less constraining on public policies designed to maximize orderly growth in industrial economies than a system of fixed exchange rates.

3. Fluctuating exchange rates would be particularly advantageous when a country is simultaneously undergoing domestic recession and balance-of-payments deficit. The depreciation in its exchange rate resulting from the balance-of-payments situation would tend to have favorable countercyclical effects on domestic economic activity.

4. Truly variable exchange rates would tend to diminish speculative movements of short-term capital by introducing more risk of loss, since the cost of the currency into which funds were moving would immediately be driven upward beyond the range permitted by fixed exchange rate margins.

5. While the principal industrial countries may not be prepared to accept a system of freely fluctuating rates, they might find feasible a modified system providing for official intervention to dampen short-run variations in the rates, and to prevent cumulative depreciation or appreciation not warranted by underlying balance-of-payments developments. Such a modified system would admittedly have two difficult but, according to its protagonists, solvable problems—one relating to the form in which monetary reserves are held and the other relating to a norm of internationally acceptable behavior as to official intervention.

6. Under a system of fixed exchange rates, currency devaluation and revaluation tend to be regarded as measures of last resort and are frequently postponed until long after their necessity has become evident. Variable rates would avoid the adverse effects on domestic and international trade and finance of prolonged periods of overvaluation or undervaluation of currencies.

7. Floating exchange rates would enable a country to avoid large changes in its momentary reserve position and the undesirable effects that such changes may have on the domestic credit base and on domestic financial conditions in general.

8. Some countries would find it possible to operate with smaller monetary reserves than at present, and thus could economize on the national resources that, under a fixed exchange rate system, have to be devoted to maintaining the monetary reserve position.

Review of arguments con

Opponents of a system of fluctuating exchange rates for the free world's principal currencies maintain that such a system would have serious disadvantages and that these would outweigh alleged advantages. Their main arguments are briefly stated below:

1. The arguments presented by advocates of variable exchange rates are not applicable to an international reserve currency such as the dollar.