2. An international payments system with fluctuating exchange rates for major industrial countries, and especially for countries whose currencies serve as international means of payments and as monetary reserves, would make foreign trade and investment transactions more uncertain and hence more speculative and costly. Every transaction would involve the risk of adverse exchange movements, the burden of which at least one of the parties would have to bear.

3. By thus impeding the international division of labor, a fluctuating rate system would both interfere with the organization and level of current economic activity and retard economic growth throughout the free world.

4. Exchange rates have a function different from that of other prices. They are the basis of international commerce, making possible comparison of trade and production advantages and disadvantages for individual commodities and services. Any change in rates affects not merely the domestic production and consumption of particular commodities and services but as well the entire system of production, distribution, and consumption of all other countries participating in world trade. In view of these far-reaching effects, changes in exchange rates need to be kept to a minimum.

5. Costs and prices under present economic conditions are not so rigid as to prevent the economies of countries with a system of fixed exchange rates from adjusting through market processes to a disequilibrium in international payments within a reasonable period.

6. A system of fluctuating exchange rates for major countries would involve serious risk that rate fluctuations would exceed in magnitude the range of movement assumed as tolerable and likely by advocates of floating rates. Speculative movements of funds would thereby be enhanced rather than limited. Destabilizing forces generated by large rate fluctuations might become cumulative, especially for a country suffering from persistent payments deficits internationally.

7. A system of variable exchange rates would not free the participating countries from having to consider their individual balance of payments in formulating domestic policies. Because of possible repercussions of exchange rate fluctuations and instabilities on domestic developments, these countries, for domestic policy purposes, would probably have to pay more attention to their international position than under a system of fixed exchange rates.

8. The paucity of the world's gold supply and the risks of keeping monetary reserves in foreign currencies of fluctuating value would hamper the intervention needed to make a "modified" system of fluctuating exchange rates workable. An international understanding, tacit or formal, as to the "rules of the game" for reconciling exchange rate policies of individual countries with each other would be essential, but neither a theoretical nor an empirical approach to the formulation of such ground rules has yet been suggested.

Staff appraisal of arguments

Choice between a fluctuating exchange rate or a fixed exchange rate is one of the most basic any country can make in providing its economy with an effective monetary mechanism, for the choice affects both the domestic and the international operation of that mechanism. A weighing of the arguments bearing on this choice for major trading countries supports, it is believed, the following judgment.

For a major industrial country, an automatically variable foreign exchange rate would not long be tolerable because of the adverse effects that such a rate would have on its international relations and also on its domestic economy. Sooner or later, the Government would find the country's foreign trade and investment activities hampered by increased risks and costs; and unless it followed domestic policies that would effectively preserve strict financial equilibrium, it would experience rather sharp fluctuations in the external value of its currency, which would further impede planning for high resource utilization and sustainable growth.

Accordingly, the Government would feel obliged to combat these adverse effects. A first response might be to abandon a system under which the exchange rate was left free to vary with market forces of supply and demand. This would involve resort to intervention in the exchange market, although still without fixed limits on the rate. But successful intervention would be difficult in the absence of willingness of the central bank to hold significant amounts of foreign currency assets and without a fixed par value as a policy guideline. These difficulties could not be overcome without reestablishing a fixed exchange rate.