Now this excess American lending and investing—in excess of real transfer—we choose to call a deficit. By so doing, we are in effect asserting that this role of financial intermediation, this role as banker, is not a valid role for a country to play.

What I am saying is that this isn't a deficit. The financial intermediation role is a valid role. Indeed, it is an essential role to a liberalized free world economy, and it falls to the United States because we stand at the apex of the world financial pyramid. Our role cannot be multilateralized just as our nuclear role cannot be multilateralized.

You see, the definition of a deficit, the traditional definition, the Department of Commerce definition, is that the deficit is the amount of liquid financial claims that other countries acquire from the United States as the result of our financial intermediation role, as a result of our lending and investing in excess of real transfer.

What I am really saying is that if we stopped doing this, we would leave a hole in the world's financial mechanism which would not be filled by any of these international monetary arrangements, and what is called a deficit, I am saying, should not be considered a state of disequilibrium. On the contrary, it is necessary to a healthy equilibrium.

Now the problem that I think concerns Dr. Mundell is this. If the United States is freed from constraints with respect to international lending and investing in excess of real transfer, which is what financial intermediation is, what is to keep us from doing either one of two things: one, easing up on credit extension and putting the world into an inflationary boom or, two, tightening up on credit and therefore imposing a severe depression on the rest of the world?

The first of these we have never done. The second of these we did do in the late 1920's. American tight money imposed for alleged domestic reasons, in 1928–29, hurt the rest of the world long before it hurt us, and imposed a depression on the rest of the world.

My answer to this is that we should commit ourselves to adopt a monetary policy geared to what seems to be reasonable from the point of view of stable world economic growth, and forgo the use of monetary policy, just to curb our private domestic boom or to provide extra domestic stimulus in a recession, and we should do this in consultation with the rest of the world, I mean arrive at our monetary policy in consultation with the major foreign countries.

Now, this is distinctly an American solution, and a true internationalist would say he would rather have a supranational central bank. I would rather have a supranational central bank, too, but I am stressing I would not rather have an international central bank, which is a very different thing.

I am also saying, I guess, that if you did have a central bank, the central bank would not only have to create liquidity, but it would have to be willing to acquire the kinds of assets that American lenders and investors acquire and that central banks usually don't touch, in order to replace the American deficit. It would also have to manage flexibly and not by rigid formula.

You know, I really think I have been talking in kind of classroom world federalist terms about this problem. I think that the world isn't ready for a true supranational solution, and I think that the very good second best is to recognize the existing organic structure