SHOULD THE UNITED STATES DEVALUE THE DOLLAR?*

By ROBERT A. MUNDELL

Somewhere in his *Journals*, Kierkegaard remarks that the master of a fishing craft knows his whole cruise before sailing, whereas a man-of-war gets its sailing orders only out at sea. In some respects we are more in the position of the man-of-war than the fishing craft, for while I was given this topic some months ago my answer has to be conditioned by the state of the sea. The sea has been rough in the past few months, and the course we set has to be altered accordingly. I am not just speaking of the new dispensation arranged in the March 17 Communique or the French uprisings. The day before yesterday Russia invaded Czechoslovakia and that itself could affect the choice of policies that are now appropriate. I shall, however, not go into those connections here; it is enough to keep them at the back of one's mind. Besides, it is not so much in the question posed or my answer to it that I hope to make my contribution, but in the way the question is approached. It is the chase rather than the catch one should look at. I shall, nevertheless, give an answer to the question at the end.

It is remarkable, in a sense, that the question can now be posed openly and discussed freely. The new gold market arrangements enable it to be discussed even by officials with a new candor. There is no longer a conspiracy of silence on the issue, although there are still billions of dollars at stake in connection with the valuation of gold stocks and the capitalized value of gold production. But the private market at least no longer has a one-way option and the market in Europe now has an escape valve. And we have a new barometer.

I. THE LEGAL SYSTEM

What does devaluation of the dollar mean? There is some ambiguity in this question that even confuses the people who can be expected to understand the exchange system. It could have one of three meanings:

(a) An increase in the official price of gold in terms of the dollar and all other currencies; technically this is a uniform *reduction* in the par value of all currencies.

(b) A *reduction* in the par value of the dollar as established at the IMF, all other par values remaining constant.

(c) An *increase* in the par value of all (or some) other currencies relative to the par value of the U.S. dollar.

It could also mean—to people over 70 at any rate—a rise in the price of commodities. I have ruled that out of the discussion since no one is advocating that kind of devaluation and it would not be helpful to encourage the disguised policies involved in speaking of a 25 cents dollar or a five cents dollar; we have enough terminological inexactitudes to put up with as it is.

It is a rather amusing commentary on the division of knowledge within social sciences that lawyers tend to think that there is no economic differences between the three types of devaluation while some economists think there is no legal difference. But it is important to keep both the legal and economic distinctions in mind, as we shall soon see.

These three possibilities are illustrated in Figure 1. On the ordinate we place the price of dollars expressed in terms of gold, and on the abscissa the price of the pound sterling in terms of gold. I shall use the price of the pound sterling for the moment as representative of the price of all foreign currencies.[1] Each point in the graph indicates three price ratios: the gold price of the dollar, the gold price of sterling and, implicitly, the dollar price of the pound (the reciprocal of the slope of a ray connecting the origin and the point, such as the line OQ).

*Plenary Session of the Western Economic Association at Corvallis, Oregon, on Thursday, August 22, 1968.

[1] This is legitimate because we are assuming implicitly that the price of all foreign currencies are constant relative to each other and can therefore utilize the Hicks-Leontief theorem on the composition of "commodities."